SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933

No. 689

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

THE INDEPENDENT LIFE INSURANCE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

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[Caption Omitted]

Before United States Board of Tax Appeals

No. 25295

THE INDEPENDENT LIFE INSURANCE CO., PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

For Taxpayer: James A. Newman, Esq.
For Commissioner: E. C. Lake, Esq.

Docket entries

1927
Mar. 17—Petition received and filed. (2).
Apr. 15—Amended petition filed by taxpayer,
" 18—Copy of amended petition served on General Counsel.
May 25—Answer to amended petition filed by G. C.
" 27—Copy of answer served on taxpayer, Gen. Cal.
1928
Dec. 8—Hearing set Jan. 29, 1929.
1929
Jan. 17—Stipulation of fact filed.
" 24—Motion to amend petition filed by taxpayer, amendment tendered.
" 25—Motion granted.
" 29—Hearing had before Mr. Sternhagen, pet. brief 3-5-29—respondent's 3-25-29—pet. reply 4-11-29.
" 28—Copy of motion and amended petition served on G. C.
Mar. 4—Brief and argument filed by taxpayer (1).
Mar. 22—Brief filed by G. C.
2 Apr. 13—Order extending time for filing petitioner's reply brief, to 4-30-29 entered.
Apr. 15—Reply brief filed by taxpayer. (1).
Oct. 4—Findings of fact and opinion rendered, John M. Sternhagen, Div. 10. Judgment will be entered under rule 50.
" 26—Notice of settlement filed by G. C.
" 31—Hearing set under Rule 50 for Nov. 20, 1929.
Nov. 8—Consent to settlement filed by taxpayer.
" 18—Judgment entered, John M. Sternhagen, Div. 10.
May 13—Petition for review by U.S. Cir. Ct. of Ap. (6) with assignment of error filed by G. C.
" 17—Proof of service filed.
July 14—Motion for extension to Oct. 1, 1930 to prepare and deliver record, filed by G. C.
" 14—Order enlarging time to Oct. 1, 1930 for preparation of evidence and delivery of records sur petition for review, entered.

1929

Oct. 1—Motion for extension of time to 11-15-30 to prepare and deliver record filed by G. C.

" 1—Order enlarging time to Nov. 15, 1930 to prepare and deliver record, entered.

Nov. 5—Statement of Evidence lodged by G. C.

" 15—Motion for enlargement of time to 12-15-30 to prepare and deliver record filed by taxpayer.

" 15—Order enlarging time to Dec. 15, 1930 for preparation and delivery of record, entered.

" 19—Agreed statement of evidence lodged.

" 19—Agreed praecipe filed, proof of service thereon.

" 20—Agreed statement of evidence approved and ordered filed.

Dec. 15—Order entered extending time for filing record to Jan. 31, 1931.

Now, Dec. 13, 1930, the foregoing Docket Entries certified from the record as a true copy.

[SEAL]

B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

3 Before U.S. Board of Tax Appeals

Amended petition

Filed April 15, 1927

Petition of the Independent Life Insurance Company of America, at Nashville, Tennessee, respectfully shows:

I

That it is aggrieved by the ruling of the Commissioner of Internal Revenue at Washington, D.C., involving the matter of a deficiency assessment upon its income for the years 1923 and 1924, the Commissioner having assessed said company upon the income on its building located at Nashville, Tennessee, based upon article 686, Regulation 62, and which said assessment, petitioner respectfully represents and shows, is erroneous and does not represent income as defined by the act but represents and is an arbitrary, false, and improper assessment, and that said regulation is itself in violation of section 245 (b) of the act of February 26, 1926, and all prior revenue acts, which define and provide the method of calculation upon which the assessment should have been made by the Commissioner of Internal Revenue.

On the 30th day of October, 1926, the Commissioner of Internal Revenue made a deficiency assessment against petitioner herein in the sum of $4,926.43, to which protest was duly and seasonably made, and thereafter, on the 25th day of January, 1927, a final assessment by the Commissioner was made, as above shown, and petitioner notified thereof, said assessment showing a deficiency of $1,414.62.

Thereafter and on the 11th day of March, 1927, and within sixty days after the deficiency assessment by the Commissioner of Internal Revenue, a petition was addressed to this honorable Board by petitioner herein and duly filed, and which is now filed and pending undetermined before this honorable Board. No answer has been filed to said petition, and petitioner herein is advised that the same is not in proper form, and it therefore brings this amended and supplemental petition, conforming to the requirements of the Board asking leave to file the same, and it hereby refers to and makes its said petition filed herein on March 11th part and parcel
4 hereof by a reference thereto, the same as if it were copied herein in its entirety and made verbatim a part of this petition.

The original letter, together with the Commissioner's assessment, is attached hereto, marked "Exhibit No. 1" to this petition, and shows the basis upon which said assessment was made.

II

The deficiency for which said assessment was made, as shown by exhibit no. 1 attached, is $298.97 for the year 1923 and $1,115.65 for the year 1924, a total deficiency of $1,414.62.

III

Petitioner assigns as error to the ruling of the Commissioner, the following:

(a) The Commissioner erred in basing the assessment upon article 686 of Regulation 62, which is in violation of section 245 (b) of the Revenue Act of February 26, 1926, and prior revenue acts.

(b) Section 245 (b) of the Revenue Act of February 26, 1926, provides that if deductions for expenses are made for the operation of any building owned and occupied in whole or in part, by a life insurance company, then the rental value of the space occupied by such company shall be fixed at a sum to provide a net income on such space equal to 4% of its book value at the end of the taxable year, while the Commissioner in his ruling and in his deficiency assessment under said article 686, of Regulation 62, has so computed the tax on the space occupied by petitioner as to make said space return a net income of 4% on the book value of the entire building at the end of the taxable year.

(c) Said article 686 of Regulation 62 is in violation of section 245 (b) of the Revenue Act of February 26, 1926, in that said revenue act provides that the space occupied by a life insurance company shall, in addition to other rents received, be calculated at a value to pay or show a net income of 4% on the book value of such space, at the end of the taxable year, while article 686 of
5 Regulation 62 provides that the space so occupied by a life insurance company shall be placed at such a value as will, together with other rents received from tenants, pay 4% on the

total valuation of the building so occupied by such insurance company, and the Commissioner of Internal Revenue has assessed petitioner under said article 686 of Regulation 62, and therefore in violation of section 245 (b) of the Revenue Act of February 26, 1926.

(d) Section 245 (b) of the Revenue Act of February 26, 1926, is to provide income upon space occupied by a life insurance company in its own building whenever deductions or credits are claimed, and such income is to pay 4% upon the book value of such space, and which shall be added to the rents received from other tenants, and the two together represent the income on such building from which such expenses are then to be deducted. Said article 686 of Regulation 62 provides a method, which, together with rents received from other tenants, will provide the net income of 4% on the entire building so occupied by such insurance company at its book value, at the end of the taxable year, over and above any expenses for the operation of such building and irrespective of the amount of such expenses, said article 686 of Regulation 62 thus providing an arbitrary income on any building occupied by said insurance company of 4% on its said book value in any and all offices, and thus constituting a direct tax on such real estate and not an income tax, as provided by said section 245 (b) of said Revenue Act.

(e) The Independent Life Insurance Company of America only occupies less than one entire floor in a twelve-story building, and yet the assessment as calculated by the Commissioner of Internal Revenue fixes the value of the said space at such a figure as to pay 4% income on the book value of the entire building.

(f) Article 686 of Regulation 62 and the action of the Commissioner of Internal Revenue thereunder, operates as a prohibition of life insurance companies from receiving credit for the expenses which they are allowed to deduct under section 245 (a) (6) and (7) of said Revenue Act of February 26, 1926, and makes said sections of said Revenue Act nugatory and void.

6 (g) The Commissioner erred in not allowing a credit as against the assessment made by him for the loss sustained in 1922 as against his assessment for the years 1923 and 1924, and which said loss is a credit to which petitioner was entitled, the loss for the year 1922 being the sum of $19,009.95.

IV

Petitioner would now show that it is a life insurance company owning a twelve-story building on the corner of Fourth Avenue North and Church Street in the city of Nashville, Davidson County, Tennessee, and that it occupies less than one floor of said building for its insurance offices. For the year 1922 it showed a net loss for the operation of its said building of $19,009.95, exclusive of an amount paid for damages as a result of an elevator accident in the sum of $15,614.18, or a total loss for said year of $34,624.13.

The book value for the year 1923 of the building which it occupies was fixed at $460,000.00 and the book value for the year 1924 of

said building was fixed at $494,257.97. The expenses of operation of said building for the year 1923 as allowed by the Commissioner are $70,005.18, and for 1924 $85,918.97. The Commissioner has accordingly fixed the value of the same identical space occupied by the company as its offices for the year 1923 at $14,784.70, and for 1924 at $34,400.08, while petitioner insists that the book value of the space so occupied by it should not be exceeding one twelfth of the book value of said building for each of said years, and that it should only be required to pay, in addition to the rents received from other tenants, 4% on such book value of the space which it occupies. The rents received from other tenants for the year 1923 was $73,620.48, and the net income from other tenants above expenses, $3,615.30. For the year 1924 the rents received from other tenants was only $71,281.21, a net loss of actual rents received as compared with the expenses for that year of $14,629.76. The Commissioner accordingly figures the value of the space for the year 1924 at such a sum
7 as shall compel petitioner to pay 4% on the book value of said building irrespectively.

V

Wherefore, petitioner prays:

(1) That it be granted a redetermination of the amount of the alleged deficiency and that the action of the Commissioner of Internal Revenue be reversed and revoked;

(2) That it be given all such other, further and general relief as it may be entitled to at the hearing.

INDEPENDENT LIFE INS. CO.
By PAUL ROBERT, *Pres.*

[*Duly sworn to by Paul Roberts, jurat, omitted in printing.*]

8

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, Jan. 25, 1927.

IT:CA:2553-9-60D
INDEPENDENT LIFE INSURANCE COMPANY,
Independent Life Bldg.,
Corner Fourth and Church Streets,
Nashville, Tennessee.

SIRS: The determination of your income-tax liability for the years 1923 and 1924, as set forth in office letter dated October 30, 1926, has been changed as the result of your letter dated November 26, 1926, to disclose a deficiency in tax amounting to $1,414.62, as shown in the attached statement.

In accordance with the provisions of section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D.C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the Collector of Internal Revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed form A, and forward it to the Commissioner of Internal Revenue, Washington, D.C., for the attention of IT:CA:2553-9-60D. In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

9

Respectfully,

D. H. BLAIR,
Commissioner.
By C. R. NASH,
Assistant to the Commissioner.

Inclosures: Statement; form A; form 882.

STATEMENT

IT:CA:2553-9-60D.

In re: Independent Life Insurance Company, Independent Life Building, Corner Fourth and Church Streets, Nashville, Tenn.

Year:	Deficiency in tax
1923	$298.97
1924	1,115.65
Total	1,414.62

1923

Income:		
Interest from all sources		$19,704.81
Rents		88,405.18
Gross income		108,109.99
Deductions:		
Interest exempt	$1,948.32	
Excess of 4% of means of reserve over exempt interest	20,363.33	
Investment expenses	1,946.00	
Taxes	11,147.72	
Other real estate expenses	51,357.46	
Depreciation	7,500.00	
Interest	8,552.48	
Total deductions		102,815.31
Adjusted net income		5,294.68

In connection with the above adjustment of gross income with respect to rents, your attention is invited to Article 686, Regulations 62, which reads in part as follows:

10 "No deduction shall be made for any taxes, expenses, or depreciation on account of any real estate owned or occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied, such rental value shall not be less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and other expenses) at the rate of 4 percent per annum of the book value at the end of the taxable year on the real estate so owned and occupied."

Book value of home office			$460,000.00
Rents received from other tenants		$73,620.48	
Less:			
Expenses	$51,357.46		
Taxes (on R. E.)	11,147.72		
Depreciation	7,500.00		
		70,005.18	
		3,615.30	
Less: 4% of $460,000		18,400.00	
Value of space owned and occupied by company to be included in gross income			14,784.70
Rents from other tenants in building in which company occupied space			73,620.48
Total rents to be reported in gross income			88,405.18

You are advised that the amount, $11,376.81, representing permanent improvements, has been eliminated from expenses in accordance with section 245 (a) (6) of the Revenue Act of 1921.

COMPUTATION OF TAX

Net income	$5,294.68	
Less: Exemption	2,000.00	
Taxable at 12½%	3,294.68	
Tax at 12½%		$411.83
Previously assessed		112.86
Deficiency in tax		298.97

1924

Income:			
Interest from all sources			20,519.85
Rents			105,689.29
Gross income			126,209.14
11 Deductions:			
Interest exempt	$1,687.81		
Excess of 4% of means of reserve over exempt interest	22,773.76		
Investment expenses	2,220.34		
Taxes	11,147.00		
Other real-estate expenses	67,271.97		
Depreciation	7,500.00		
Interest	868.69		
Total deductions			113,569.57
Adjusted net income			$12,739.57

The adjustment for rents is made for the same reasons as given in 1923. The computation is as follows:

Book value of home office			$494,257.97
Rents received from other tenants		$71,289.21	
Less:			
Expenses	$67,271.97		
Taxes (on R. E.)	11,147.00		
Depreciation	7,500.00		
		85,918.97	
		14,629.76	
Add: 4% of $494,257.97		19,770.32	
Value of space owned and occupied by company to be included in gross income			$34,400.08
Rents from other tenants in building in which company occupied space			71,289.21
Total rents to be included in gross income			$105,689.29

COMPUTATION OF TAX

Net Income	$12,739.57
Less: Exemption	2,000.00
Taxable at 12½%	$10,739.57
Tax at 12½%	$1,342.44
Previously assessed	226.79
Deficiency in tax	$1,115.65

Your return for the year 1922 has been closed, showing no tax liability.

12 You are advised that the contentions contained in your letter dated November 26, 1926, have been allowed with the exception of permanent improvements included in expenses for 1923.

Payment of the tax should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, Oct. 30, 1926.

IT:CA:2353-9.

INDEPENDENT LIFE INSURANCE COMPANY,
Independent Life Building,
Corner Fourth and Church Streets, Nashville, Tennessee.

SIRS: An audit of your income-tax returns for the years 1922, 1923, and 1924 discloses a deficiency in tax amounting to $4,926.43, as shown in the attached statement.

You are granted 30 days from the date of this letter within which to present a protest against the deficiency proposed herein. The protest and any additional statements of facts must be executed in triplicate, under oath, and contain the following information:

(a) The name and address of the taxpayer (in the case of an individual the residence, and in case of a corporation the principal

office or place of business); (b) in the case of a corporation the name of the State of incorporation; (c) the designation by date and symbol of the letter advising of the proposed deficiency with respect to which the protest is made; (d) the designation of the year or years involved and a statement of the amount of tax in dispute for each year; (e) an itemized schedule of the findings to which the taxpayer takes exception; (f) a summary statement of the grounds upon which the taxpayer relies in connection with each exception; and (g) in case the taxpayer desires a hearing, a statement to that effect.

If a protest is filed, any additional evidence or briefs of argument submitted will be given careful consideration, and if the
13 Commissioner finally determines that there is a deficiency, you will be advised thereof by registered mail in accordance with the provisions of section 274 of the Revenue Act of 1926. Should you not agree to the deficiency as finally determined by the Commissioner, you will be allowed 60 days from the mailing of the registered letter in which to file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

If you acquiesce in the proposed deficiency as shown in this letter and the accompanying statement, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the enclosed form A, and forward it to the Commission of Internal Revenue, Washington, D.C., for the attention of IT:CA:2553–9. In the event that you acquiesce in a part of such deficiency, the waiver should be executed with respect to the items to which you agree.

Respectfully,

C. R. NASH,
Assistant to the Commissioner.
By F. R. CLUTE,
Head of Division.

Enclosure: Statement; Waiver—Form A. Ford 882.

STATEMENT

IT:CA:2553–9

In re: Independent Life Insurance Company, Independent Life Building, Corner Fourth and Church Streets, Nashville, Tennessee.

Years	Deficiency in tax
1922	$162.66
1923	2,730.17
1924	2,033.06
Total	$4,926.43

1922 ADJUSTMENTS TO INCOME

Net loss reported		$5,294.00
Add:		
1. Taxes deducted on return	$10,574.00	
Amount allowed	6,250.00	
		$4,324.00

Add:			
14 2. Other real estate expenses	$43,798.50		
Amount allowed	39,993.62		
		$3,804.88	
3. Depreciation deducted	$6,466.40		
Amount allowed	5,000.00		
		1,466.40	
Total		9,595.28	
Less: 4. Error in addition		1,000.00	
			$8,595.28
Adjusted net income			$3,301.28

EXPLANATION OF ADJUSTMENTS TO INCOME

1. You are advised that capital stock tax is not an allowable deduction in accordance with section 245(a) (6) of the Revenue Act of 1924.

2. Other real-estate expenses have been adjusted to agree with your report as rendered to the Insurance Department of the State of Tennessee.

3. Depreciation claimed on truck has been disallowed in accordance with section 245(a) (7) of the Revenue Act of 1924.

4. Gross income as shown on return as $78,384.77, whereas the correct amount is $77,384.77.

COMPUTATION OF TAX

Net income	$3,301.28
Less: Exemption	2,000.00
Taxable at 12½%	$1,301.28
Tax at 12½%	162.66
Previously assessed	None
Deficiency in tax	$162.66

1923, ADJUSTMENTS TO INCOME

Net income reported			$2,902.94
Add:			
(1) Taxes deducted on return	$11,147.72		
Amount allowed	6,793.60		
		$4,354.12	
(2) Other real estate expenses deducted on return	51,357.46		
Amount allowed	34,695.92		
		16,661.54	
15 (3) 4% of the mean of reserve over exempt interest	$20,443.33		
Amount allowed	20,363.33		
		80.00	
(4) Interest on indebtedness deducted	$10,302.48		
Amount allowed	8,552.48		
		1,750.00	
			22,845.66
Total			$25,748.60
(5) Error in subtraction on return			1,000.00
Adjusted net income			$24,748.60

EXPLANATIONS OF ADJUSTMENTS TO INCOME

(1) and (2) The adjustments 1 and 2 are made for the same reason as given in 1922.

(3) It is noted that under item 1 of schedule C, as at the beginning of taxable year, you show an amount of $520,575.56, whereas the correct amount is $516,575.72.

(4) You are advised that accrued interest is not an allowable deduction.

(5) On return you show the difference between the total of gross income $99,048.25 and total of deductions $97,143.31, as $2,902.94, whereas the correct amount is $1,902.94, error of $1,000.00.

COMPUTATION OF TAX

Net income adjusted		$24,748.60
Less: Exemption		2,000.00
Taxable at 12½%		$22,748.60
Tax at 12½%		$2,843.57
Previously assessed		112.86
Deficiency in tax		$2,730.71

1924, ADJUSTMENTS TO INCOME

Net income reported on return			$3,814.59
Add:			
16 (1) Taxes deducted on return	$11,147.00		
Amount allowed	9,148.87		
			1,998.13
(2) Other real estate expenses deducted on return	$55,492.93		
Amount allowed	41,226.84		
			14,266.09
Adjusted net income			$20,078.81

(1) and (2) The above adjustments are made for the same reason as given for 1922.

COMPUTATION OF TAX

Net income	$20,078.81
Less: Exemption	2,000.00
Taxable at 12½%	$18,078.81
Tax at 12½%	$2,259.85
Previously assessed	226.79
Deficiency in tax	$2,033.06

Payment of the tax should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him.

Now, Dec. 13, 1930, the foregoing amended petition certified from the record as a true copy.

[SEAL] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

17 Before U.S. Board of Tax Appeals

Answer to amended petition

Filed May 25, 1927

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, general counsel, Bureau of Internal Revenue, for answer to amended petition of the above-named taxpayer, admits and denies as follows:

(1) Admits the allegations contained in paragraph II of the petition.

(2) Denies the respondent erred in the determination of the tax liability of the petitioner for the years 1922 and 1923.

(3) For lack of information upon which to form a belief, denies the allegations contained in the paragraphs under item IV of the petition.

(4) Denies generally and specifically each and every allegation of the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the appeal be denied.

A. W. GREGG,
General Counsel,
Bureau of Internal Revenue.

Of counsel:
GRANVILLE S. BORDEN,
Special Attorney,
Bureau of Internal Revenue.

Now, Dec. 13, 1930, the foregoing answer to amended petition certified from the record as a true copy.

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

Before U.S. Board of Tax Appeals

Motion for leave to amend petition

Filed Jan. 24, 1929. Granted Jan. 25, 1929

B. H. LITTLETON,
Member, U.S. Board of Tax Appeals.

Your petitioner, The Independent Life Insurance Company of America, an insurance corporation existing under the laws of
18 the State of Tennessee, with its principal office and place of business at Nashville, respectfully moves the Court for an order authorizing and permitting it to amend its petition heretofore filed in this cause, for the following reasons and in the following particulars and manner, to wit:

I

Your petitioner shows at the time of the preparation of its petition herein by counsel, but a short time remained within which to file the same and it was prepared in great haste, and that thereunder petitioner sought and undertook to raise the invalidity of the deficiency assessment by reason of the fact that the rules and regulations of the Commissioner and the Treasury Department under which the same was made was in violation of the provisions of the revenue act under which the income tax was payable and that if not, but in conformity therewith, then the said provisioins of the income tax law under which the tax was levied and collected was in violation of the provisions of the Constitution of the United States prohibiting direct taxes except by apportionment among the States, but in assisigning errors in said petition the revenue act referred to was that of February 26, 1926; when it should have been to the Revenue Acts of 1921 and 1924, the reficiency assessment covering the income tax for the year 1923 and 1924. And, under one of the assignments of error by which the question of the constitutionality of the act was sought to be tested, on the ground of constituting a direct tax and not income tax, the assignment was made in general terms and not specifically.

Inasmuch, therefore, as the questions raised by petitioner are ones of law and not of fact, and for the above reasons, petitioner desires leave to make amendments to its petition in such manner and form as to assign errors in conformity with the above, and accompanies this motion with its proposed amendment.

Wherefore, your petitioner moves the Court that it be granted an order allowing it to file its said amendment to its petition heretofore filed in the cause, amending said petition in
19 conformity therewith, and that if required, a date for hearing of this mot'on be set and a copy hereof be served upon the Commissioner.

A copy of the motion and amendment has been forwarded to the Commissioner by registered mail on the 22nd day of January 1929.

Respectfully,

INDEPENDENT LIFE INSURANCE CO. OF AMERICA,
By JAMES A. NEWMAN, *Solicitor.*

JAMES A. NEWMAN,
Solicitor for Petitioner.

Now, Dec. 13, 1930, the foregoing motion to amend petition and order granting same certified from the record as a true copy.

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

Before U.S. Board of Tax Appeals

Amendment to petition

Filed Jan. 25, 1929

That section III of pages 3 to 6, inclusive, of the petition, be amended so as to change the reference in subsections (a) to (f), both inclusive, from section 245(b) of the Revenue Act of February 26, 1926, in all cases where said references occur, to sections 243, 244, and 245 of the Revenue Act of November 23, 1921, and said sections of the Revenue Act of June 2, 1924, and by adding to said section III of the petition the following additional assignments of error:

(h) Subsection (b) of section 245 of the Revenue Acts of 1921 and 1924, insofar as the same provides that in determining the rental value of space occupied by an insurance company in a building owned by it in that "such rental value shall be not less than a sum which, in addition to any rents received from other tenants, shall provide a net income (after deducting taxes, depreciation, and all other expenses), at the rate of four per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied", is in violation of section 243 of the Revenue Act of 1921 and 1924, in that it constitutes a tax not based upon net income.

(i) Section 245 of the Revenue Acts of 1921 and 1924 constitutes a tax upon the gross income from rents of an insurance company and not a tax upon the net income thereof, as provided in section 243 of said acts.

(j) Subsection (b) of section 245 of the Revenue Acts of 1921 and 1924 is in violation of article I, section 9, clause 4 of the Constitution of the United States, which provides that "no capitation or other direct tax shall be laid unless in proportion to the census or enumeration herein before directed to be taken", in that under said clause of said section of these acts a direct tax is laid upon the property of an insurance company.

(k) Subsection (b) of section 245 of the Revenue Acts of 1921 and 1924 is in violation of article I, section 2, clause 3 of the Constitution of the United States, which provides that "Representatives and direct taxes shall be apportioned among the several States which may be included within its Union, according to their respective numbers, which shall be determined by adding to the whole number of free persons, including those bound to service for a term of years, and excluding Indians not taxed, three fifths of all other persons", in that the taxes levied under said section and subsection of said revenue acts was not upon the basis of apportionment in conformity with the Constitution of the United States.

(1) That subsection (b) of section 245 of the Revenue Acts of 1921 and 1924 imposes a tax upon the income of insurance companies and derived from rents of its property, when owned or occupied in whole or in part by it, either upon the gross income and not net income, as provided by section 243 of said acts, or is a direct tax upon the property of insurance companies, in violation of article I, section 9, clause 4, and article I, section 2, clause 3, of the Constitution of the United States.

Respectfully submitted this 22nd day of January 1929.

INDEPENDENT LIFE INSURANCE CO. OF AMERICA,
By JAMES A. NEWMAN.

JAMES A. NEWMAN,
Solicitor for petitioner,
1205 Independent Life Bldg., Nashville, Tennessee.

Now, Dec. 13, 1930, the foregoing amendment to petition certified from the record as a true copy.

B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

Before U.S. Board of Tax Appeals

Findings of fact and opinion

Docket No. 25295. Promulgated October 4, 1929

1. Section 245 (b) denies to an insurance company any deduction for taxes, expenses, and depreciation on account of real estate owned and occupied by it in whole or in part, unless the rental value of the space so occupied is included in gross income, and provides "such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied." Held, that th' 4 percent minimum must be computed upon the book value of the entire building rather than the value of the space occupied by the company.

2. Because the statutory definition of gross income of life insurance companies in section 244 includes only interest, dividends, and rents, no other factors of gross income may be considered as part of the net income in determining the validity of tax thereon.

3. The Board has authority to consider and decide an issue, properly raised, of the constitutionality of a provision of the revenue act in determining the validity of a deficiency determined by the Commissioner.

4. The rental value of real estate occupied by the owner is not income under the sixteenth amendment, and a tax thereon is not an

income tax but a direct tax upon the real estate which, without apportionment, is unconstitutional.

5. A requirement that, unless rental value of real estate occupied by the owner be included in gross income in computing taxable net income, no deductions shall be made of taxes, expenses, and depreciation in respect of real estate, is invalid. National Life Insurance Co. v. United States, 277 U.S. 508.

6. A requirement that, in computing taxable net income, rental value shall be so computed as to result in a percentage minimum net rental upon the value of the real estate of the taxpayer irrespective of the actual net income or loss therefrom, renders the tax therein a direct tax upon the realty itself and not upon income; and, without apportionment, such a tax is unconstitutional.

7. The use, in computing such minimum net rental, of "book value" as the basis of the percentage to be used in computing taxable net income, renders the tax a direct tax upon something other than income; and, without apportionment, unconstitutional.

James A. Newman, Esq., for the petitioner.

E. C. Lake, Esq., for the respondent.

23 *Opinion*

STERNHAGEN: The Commissioner notified petitioner of a determination of deficiencies in income tax of $298.97 for 1923 and $1,115.65 for 1924. Petitioner attacks this determination as contrary to the Revenue Act of 1921, sections 242 et seq., and similar sections of the Revenue Act of 1924, and, if necessary, contrary to the Constitution.

The facts are presented in the following stipulation:

It is hereby stipulated and agreed by and between the parties to the above-entitled appeal, by their respective counsel:

(1). That the petitioner, Independent Life Insurance Company of America, is a life insurance company, with its home office located at Nashville, Tennessee.

(2). That on January 25, 1927, the respondent mailed to the petitioner a notice of deficiency, showing proposed deficiencies for the calendar years 1923 and 1924 in the amounts of $298.97 and $1,115.65, respectively. A copy of said notice of deficiency is attached hereto as exhibit A, it being agreed that the book value of petitioner's building for the years 1923 and 1924 and the amounts shown therein as rents received from other tenants covering space occupied by others than the company are correct and the facts in this case.

(3) That during the years 1923 and 1924 the petitioner owned a twelve-story building located in the city of Nashville, Tennessee. The petitioner in 1923 and 1924 occupied about one story of said building as its home office and rented such portions of the remainder of the building as it was able to secure tenants for.

EXHIBIT A

INDEPENDENT LILE INSURANCE COMPANY, JAN. 25, 1927.
Independent Life Building,
Corner Fourth and Church Streets, Nashville, Tennessee.

SIRS: The determination of your income-tax liability for the years 1923 and 1924, as set forth in office letter dated October 30, 1926, has been changed as the result of your letter dated November 26, 1926, to disclose a deficiency in tax amounting to $1,414.62, as shown in the attached statement.

STATEMENT

IT:CA:2553-9-60D

In re: Independent Life Insurance Company, Independent Life Building, Corner Fourth and Church Streets, Nashville, Tennessee

Years:	Deficiency in tax
1923	$298.97
1924	1,115.65
Total	$1,414.62

1923

Income:		
Interest from all sources		$19,704.81
Rents		88,405.18
Gross income		$108,109.99
Deductions:		
Interest exempt	$1,948.32	
Excess of 4% of mean of reserve over exempt interest	20,363.33	
Investment expenses	1,946.60	
Taxes	11,147.72	
Other real estate expenses	51,357.46	
Depreciation	7,500.00	
Interest	8,552.48	
Total deductions		$102,815.31
Adjusted net income		$5,294.68

In connection with the above adjustment of gross income with respect to rents, your attention is invited to article 686, Regulations 62, which reads in part as follows:

"No deduction shall be made for any taxes, expenses, or depreciation on account of any real estate owned or occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied, such rental value shall not be less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation and other expenses) at the rate of 4 percent per annum of the book value at the end of the taxable year on the real estate so owned and occupied."

25	Book value of home office		$460,000.00
	Rents received from other tenants	$73,620.48	
	Less:		
	Expenses	$51,357.46	
	Taxes (on R.E.)	11,147.72	
	Depreciation	7,500.00	
		70,005.18	
		$3,615.30	
	Less: 4% of $460,000.00	18,400.00	
	Value of space owned and occupied by company to be included in gross income		$14,784.70
	Rents from other tenants in building in which company occupied space		73,620.48
	Total rents to be reported in gross income		$88,405.18

You are advised that the amount, $11,376.81, representing permanent improvements, has been eliminated from expenses in accordance with section 245 (a) (6), of the Revenue Act of 1921.

COMPUTATION OF TAX

Net income	$5,294.68	
Less: Exemption	2,000.00	
Taxable at 12½%	$3,294.68	
Tax at 12½%		$411.83
Previously assessed		112.86
Deficiency in tax		$298.97

1924

Income:		
Interest from all sources		$20,519.85
Rents		105,689.29
Gross income BS:3		$126,209.14
Deductions:		
Interest exempt	$1,687.81	
Excess of 4% of mean of reserve over exempt interest	22,773.76	
Investment expenses	2,220.34	
Taxes	11,147.00	
Other real estate expenses	67,271.97	
Depreciation	7,500.00	
Interest	868.69	
Total deductions		$113,469.57
Adjusted net income		$12,739.57

26 The adjustment for rents is made for the same reason as given in 1923. The computation is as follows:

	Book value of home office		$494,257.97
	Rents received from other tenants	$71,289.91	
	Less:		
	Expenses	$67,271.97	
	Taxes (on R.E.)	11,147.00	
	Depreciation	7,500.00	
		85,918.97	
		$14,629.76	
	Add: 4% of $494,257.97	19,770.32	

Value of space owned and occupied by company to be included in gross income	$34,400.08
Rents from other tenants in building in which company occupied space	71,289.21
Total rents to be included in gross income	$105,689.29

COMPUTATION OF TAX

Net income	$12,739.57
Less: Exemption	2,000.00
Taxable at 12½%	$10,739.57
Tax at 12½%	1,342.44
Previously assessed	226.79
Deficiency in tax	$1,115.65

Your return for the year 1922 has been closed, showing no tax liability.

You are advised that the contentions contained in your letter dated November 26, 1926, have been allowed with the exception of permanent improvements included in expenses for 1923.

Payment of the tax should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him.

Insurance companies, including domestic life companies, are subject to a special method of income tax, which is set forth in title II, Revenue Acts of 1921 and 1924, beginning with section 242. National Life Insurance Co. v. United States, 277 U.S. 508; Metropolitan Life Insurance Co., 8 B.T.A. 938; John Hancock Mutual Life Insurance Co., 10 B.T.A. 836; Midland National Life Insurance Co., 14 B.T.A. 200.[1]

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The principal characteristic of this special method is that, instead of defining gross income broadly, as is done in section 233 in respect

[1] An explanation of the special scheme is found in the testimony on September 6, 1921, of Dr. Thomas S. Adams, tax adviser, Treasury Department, before the Senate Committee on Finance, 67th Congress, during its consideration of H.R. 8245, which became the Revenue Act of 1921. Hearings, pages 83 to 95, inclusive. The report of the House Committee on Ways and Means is as follows:

LIFE INSURANCE COMPANIES

Sections 242–246: The provisions of the present law applicable to life insurance companies are imperfect and productive of constant litigation. Moreover, the taxes paid by life insurance companies under the income tax are inadequate. It is accordingly proposed in lieu of all other taxes to tax life insurance companies on the basis of their investment income from interest, dividends, and rents, with suitable deductions for expenses fairly chargeable against such investment income. The new tax would yield a larger revenue than the taxes which it is proposed to replace.

The report of the Senate Committee on Finance is as follows:

TAXES ON LIFE INSURANCE COMPANIES

Sections 242–246 provide a new plan for the taxation of life insurance companies, substantially similar to the plan embodied in the Revenue Act of 1918 as first adopted by the Senate. The provisions of the present law applicable to life insurance companies are imperfect and productive of constant litigation. The proposed plan would tax life insurance companies on the basis of their investment income from interest, dividends, and rents, with suitable deductions for expenses fairly chargeable against such investment income. The new tax would take the place of the present income and excess-profits taxes for the year 1921, and life insurance companies would share with other
28 insurance companies in the repeal in the year 1922 of the capital stock tax and the taxes imposed by section 503. The new tax will yield a larger revenue than the taxes which it is proposed to replace.

See also Holmes, Federal Taxes, Sixth Edition, p. 317, et seq.; Montgomery, Income Tax Procedure, 1927, ch. 44; Foulke, The Federal Income Tax, ch. 38.

of other corporations generally, it adopts a special definition which includes only so-called "investment income" consisting of interest, dividends, and rents, and excludes all other income, such as premium receipts and profits from sales of securities or other assets. The tax is levied at the same percentage of defined net income as is applied by section 230 to other corporations. Net income is defined as gross income less specified items described in nine subdivisions of section 245, subsection (a). Of these deductions, only (6) and (7) are important in this proceeding; and the material parts thereof, together with subsection 245 (b), are as follows:

(6) Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. ***

(7) A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence. ***

* * * * * * *

(b) No deduction shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate owned and
29 occupied in whole of in part by a life insurance company, unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied.

Regulation 62, under the Revenue Act of 1921 and Regulations 65 under the Revenue Act of 1924 contain the following article:

"ART. 686. Home office properties.—No deduction shall be made for any taxes, expenses, or depreciation on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall not be less than a sum which in addition to any rents received from the other tenants shall provide a net income (after deducting taxes, depreciation, and other expenses) at the rate of 4 percent per annum of the book value at the end of the taxable year of the real estate so owned and occupied. For example, if the book value of a parcel of real estate owned and occupied in whole or in part by the company is $1,000,000, the rents received from other tenants $30,000, taxes and expenses $40,000, and depreciation $20,000, the company would have to include in its gross income a sum not less than $70,000 ($40,000 taxes and expenses, plus $20,000 depreciation, minus $30,000 rents from tenants, plus 4 percent of $1,000,000) as the rental value of the space occupied

by it in order to avail itself of the deductions of $40,000 and $20,000. In any case the rents received from other tenants must be included in gross income."

The petitioner claimed and was allowed deductions under (6) and (7) in respect of the entire building which it owned and in part occupied, and there has been no dispute as to the amounts of the deductions. For 1923, they aggregated $70,005.18 and for 1924, $85,918.97. Nor is it disputed that, within the meaning of subsection (b), the book value of the entire building was, at the end of 1923, $460,000, and of 1924, $49,257.97, of which 4 percent is $18,400 and $19,770.32, respectively. The gross rents received from other tenants were $73,620.48 and $71,289.21, respectively. Neither the rental value nor the book value of the space occupied by petitioner is in evidence, and it can not be inferred, as petitioner suggests, that the amount is one twelfth of the stipulated book value.

The respondent's method of computing the figure to be included in gross income under subsection (b) to support any deduction under (6) and (7) is based upon the assumption that the statute required a minimum net rent of 4 percent of the book value of the entire building. In order to arrive at this figure he includes as rental value of the space occupied by petitioner, $14,784.70 for 1923 and $34,400.08 for 1924. The petitioner insists that such figures are not in accordance with the statute and that the error lies in assuming that the 4 percent minimum provided by the last sentence of section 245 (b) is computed upon the book value of the entire building. The contention is that the statutes "provide that the sum to be returned as rents for the space so occupied, is 4 percent of the book value of such space at the end of the taxable year." The method thus urged by petitioner is to add to rents actually received (less taxes, depreciation, and expenses) an amount equal to 4 percent of the book value of the space occupied by it.[2] Since such book value is not in evidence, petitioner would fail, even if its construction of the statute were correct. But, in our opinion, such construction

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[2] If we were to adopt petitioner's suggestion that book value of space occupied is one twelfth of the stipulated book value of the entire building, petitioner's method would be for 1923 to add to ($73,620.48 less $70,005.18 or $3,615.30) an assumed rental value of (4% of 1-12 of $460,000 or $1,533.33). Thus the rent from the entire building would be taken to be

Rent actually received	$73,620.48
Rental value of space occupied	1,533.33
Gross rent	$75,153.81
Deductions	70,005.18
Net rent taxed	$5,148.63

Instead of which respondent's method arrives at $18,400 or 4% of the book value of the building.

For 1924 petitioner would add to ($71,289.21 less $85,918.17 or minus $14,628.96) an assumed rental of (4% of 1-12 of $494,257.97 or $1,647.52). The rent from the building would thus be—

Rent actually received	$71,289.21
Rental value of space occupied	1,647.52
Gross rent	$72,936.73
Deductions	85,918.17
	$12,981.44

Respondent takes $19,770.32 as net rent.

is without support in either the terms or the theory of the statute. The respondent's method fulfills the clear legislative purpose and is consistent with the context.

The primary purpose of subsection (b) is to correlate gross income from real estate with deductions from real estate. Since deductions are allowed as to the entire building, gross income is likewise computed. To apply depreciation, taxes, and expenses of the entire building against rents received from part would be a distortion. The obvious purpose of augmenting rents actually received by rental value of space occupied was to effect a sym'etry. The 4 per cent minimum was an aid in arriving at a figure to be used as net rent from the entire building. It would assure a net rent great enough to justify the deductions permitted, and reduce controversy as to actual rental value.

32 The construction urged by petitioner is in effect that rental value of the space occupied should be not less than 4 per cent of the book value thereof. Had this been meant, it could have been so simply stated that we can not believe Congress would have used a locution so much more complicated. While the closing words "owned or occupied" are grammatically somewhat obscure, they may fairly be read in consonance with the plain intendment of the statute as above set forth.

It is our opinion, therefore, that respondent has correctly construed the statute and that the deficiencies determined are in accordance therewith.

The petitioner contends that this construction of the statute renders it unconstitutional, and urges that such a result will be avoided by adopting its own construction, as above described. There is, of course, a well recognized doctrine that doubtful statutory construction involving possible unconstitutionality should always be rejected in a favor of a reasonable construction by which the constructional conflict can be avoided. United States vs. Delaware & Hudson Co., 213 U.S. 266; Lucas vs. Alexander, U.S. But we do not understand this to require an interpretation of the statute which seems clearly at variance with the plan and purpose indicated by the plain meaning of the language used. So long as there seems to us to be no ambiguity in the statute, we are constrained to apply it according to its tenor and terms, and not to strain it into a strange meaning in order to avoid an attack of unconstitutionality. That would be to rewrite the law and substitute for the plain legislation adopted by Congress after deliberation a more subtle design not contemplated, or perhaps purposely rejected. The Board's power of interpretation does not include such a function. Furthermore, if the statute is unconstitutional as contended, the petitioner's construction does not save it. The weakness alleged to be inherent is, as will be hereafter seen, equally applicable under either construction. For if the attempted inclusion in income of rental value of space occupied by the owner and its computation at a percentage minimum, as prescribed, are contrary to the Constitution, this must be no

33 less so when petitioner's method is used resulting in a smaller minimum than under respondent's method resulting in a greater. In either case, it is the inclusion of rental value, actual or minimum, upon which the attack centers under the Constitution.

Respondent insists that the statute is not in violation of the Constitution and that the Board should on the merits decide it to be valid. We are therefore confronted squarely with the opposing contentions, and we see no reason why we should refrain from considering them and deciding on this ground whether the deficiency determined by the Commissioner is lawfully due from petitioner.

The petitioner contends that the act purports to impose an income tax upon rental value, that this is not income, that the effect is to impose a direct tax without apportionment, and that this is as much so when the method used is to allow deductions upon condition that gross income shall contain improper inclusions as it would be if the tax were in all instances expressly based on items not income; further, that the minimum required to be returned as income from the building and the method of arriving at it by the mathematical formula contained in the second sentence of section 245 (b) are invalid as having no relation to income.

That the tax was intended to be an income tax is plain. The statute in which it is found contains numerous titles. Title II is called income tax and, except for general administrative provisions, purports to impose the income tax and to contain all the provisions relating thereto. More especially, the insurance sections expressly impose a tax on income, in lieu of the general corporation income tax of section 230, and define the "net income" which is the subject of the tax. Other titles and other sections impose the profits tax and various excise taxes. It seems entirely proper, therefore, to judge this tax by the standards of an income tax under the sixteenth amendment, cf. Flint v. Stone Tracy Co., 220 U.S. 107, and not to lift it into some other category with tests more liberal or strict than those which presumably were intended to be ap-

34 plied. In Pollock v. Farmers Loan & Trust Co., 157 U.S. 429, 158 U.S. 601; Eisner v. Macomber, 252 U.S. 189; and National Life Insurance Co. v. United States, 277 U.S. 508, the Supreme Court made it clear that a tax which, when judged by its own terms, was contrary in effect to the requirements of the Constitution would be condemned. The inclusion of stock dividends in gross income was held in Eisner v. Macomber, supra, to result in direct tax and was condemned for want of apportionment; and the Court did not find it necessary to inquire whether there was any way of saving it by calling it an excise tax subject only to geographical uniformity. And in the National Life Insurance Co. case, supra, the Court rejected the argument contained in the briefs of counsel that the very tax on insurance companies now at bar in truth and excise tax and as such not open to attack. See also Spraeckels v. McClain, 192 U.S. 397.

Respondent suggests, however, that since Congress has not measured the tax by using all petitioner's income, such as premium receipts or sales profits, as it might have done, petitioner could only complain by showing that the tax now determined for assessment is greater in amount than it would have been if Congress had used its power to the full extent. The argument is in effect the same as saying that since Congress might have established a percentage rate of tax of 50 percent instead of the 12½ percent used, no one may complain if by including in gross income except items like stock dividends or tax-exempt interest, he is only taxed at a rate of 40 percent. By defining statutory gross income to include only interest, dividends, and rents, the intention was disclosed to omit all other factors from consideration. National Life Insurance Co. v. United States, supra. The effect otherwise would be to include premium receipts in gross income to the uncertain extent necessary to make up in each case for items improperly included, such as interest from State securities, or capital property like stock dividends, and thus to defeat the manifest legislative purpose to leave premium receipts entirely out of the income taxed. Thus to Congress would be ascribed the recondite purpose of ostensibly releasing
35 premiums from tax while actually requiring them to be used to validate particular taxes which would otherwise invade constitutional rights. We reject this and treat the statute as candidly expressing its design and purpose. "The plain, obvious, and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover." Lynch v. Alworth-Stephens Co., 267 U.S. 364. Looking, therefore, at the statute before us in the light in which it was enacted, that of an income tax, and its purpose to tax only income found in interest, dividends, and rents, we examine it to see whether it has mistakenly employed means to bring about an effect prohibited by the Constitution.

In respondent's determination for 1924 it appears that the taxes, expenses, and depreciation amounted to $85,918.97, while the rents actually received were $71,289.21, thus showing a financial loss of $14,629.76. Whether there would be a loss if the income derived from the business conducted by petitioner in the space were reckoned in the computation is unknown, but since the statute expressly leaves such income out of the equation we may not inquire. The loss is required to be overcome by the treatment as gross income of rental value of the space occupied, and a hypothetical rental value computed upon a mathematical formula is to be used as a minimum irrespective of its remoteness from value in fact. The formula prescribed brings about a rental value of space occupied which varies inversely with the actual rents received from the comparable space rented. The entire net rent is in any event to be taken at 4 percent of book value; the rents received and deductions are factually cer-

tain, hence the rental value of space occupied must always be such a figure as happens to be needed to make up the 4 percent minimum. Thus when the net rent received is low, the hypothetical rental value of space occupied is high, and vice versa; although the converse is not true if the taxpayer's actual rental value is greater than
36 the figure used to make up the 4 percent minimum. In the present case the taxpayer occupied about one out of twelve stories. For 1923 it received actual rents of $73,620.48 for eleven stories, the expenses, taxes, and depreciation were $70,005.18, and the one story occupied was consequently valued at $14,784.70 in order to arrive at the minimum 4 percent of the book value of $460,000. For 1924 rents received dropped to $71,289.21, expenses increased to $85,918.97, and the one story was consequently valued at $34,400.08 (more than double the 1923 figure) to maintain the 4 percent of book value of $494,257.97.

The petitioner insists that this illustrates an attempt to tax as income a figure which is not income and which has no reasonable relation to income. This contention affects only the validity of the use of a purely mathematical rental value and of the particular method prescribed in the second sentence of section 245 (b) to arrive at a figure to be used in lieu of the actual rental value. The suggestion also arises that since "book value" has no necessary relation to actual value, Virginia v. West Virginia, 238 U.S. 202, a percentage based thereon to arrive at a minimum rental value has no relation to income. But the more sweeping objection is that by requiring that rental value be included in gross income in order to permit the deductions, a direct tax has been laid without apportionment upon something other than income, and that this is contrary to article I, section 9, of the Constitution and not within the sixteenth amendment.

Notwithstanding the tremendous weight of the presumption of constitutional validity to be attributed to this, as to all other, acts of Congress, and the consequent disposition of the Board to consider with skepticism any argument with which it is attacked, we can find no reasonable escape from the conclusion that the act conflicts with the Constitution and that the deficiency cannot be sustained.

In Pollock v. Farmers Loan & Trust Co., 157 U.S. 429, 158 U.S. 601, it was taken as beyond argument that a tax upon real property by reason of its ownership and based upon its value was a direct tax requiring apportionment, as it has been said to be from the
37 beginning of the Government. Hylton v. United States, 3 Dall. 171; Veazie Bank v. Fenno, 8 Wall. 533; Scholey v. Rew, 23 Wall. 331; Springer v. United States, 102 U.S. 586. It was upon this as an axiom that it was decided in the Pollock case that the tax on income from real estate in the form of rents was so truly a tax on the real estate itself as to be likewise a direct tax, at that time requiring apportionment. In the first opinion in the Pollock case, the Court said:

"* * * The real question is, is there any basis upon which to rest the contention that real estate belongs to one of the two great classes of taxes, and the rent or income which is the indictment of its ownership belongs to the other? We are unable to perceive any ground for the alleged distinction. An annual tax upon the annual value or annual user of real estate appears to us the same in substance as an annual tax on the real estate, which would be paid out of the rent or income. This law taxes the income received from land and the growth or produce of the land. Mr. Justice Paterson observed in Hylton's case, 'land, independently of its produce, is of no value', and certainly had no thought that direct taxes were confined to unproductive land."

In the second opinion appears the following:

"The Constitution prohibits any direct tax, unless in proportion to numbers as ascertained by the census, and, in the light of the circumstances to which we have referred, is it not an evasion of that prohibition to hold that a general unapportioned tax, imposed upon all property owners as a body for or in respect of their property, is not direct, in the meaning of the Constitution, because confined to the income therefrom?

"Whatever the speculative views of political economists or revenue reformers may be, can it be properly held that the Constitution, taken in its plain and obvious sense, and with due regard to the circumstances attending the formation of the Government, authorizes
a general unapportioned tax on the products of the farm and
38 the rents of real estate, although imposed merely because of
ownership, and with no possible means of escape from payment, as belonging to a totally different class from that which includes the property from whence the income proceeds?

"There can be but one answer, unless the consti'utional restriction is to be treated as utterly illusory and futile, and the object of its framers defeated. We find it impossible to hold that a fundamental requisition deemed so important as to be enforced by two provisions, one affirmative and one negative, can be refined away by forced distinctions between that which gives value to property and the property itself."

What ever may be said about the nature under the Constitution of a tax upon income derived from sources other than real estate, an inquiry not required by the present case, there is little ground for doubt that a tax on real estate is a direct tax, and that a tax on the income therefrom was held to be equally so. Cf. Brushaber v. Union Pacific Railroad Co., 240 U.S. 1. Before the sixteenth amendment, both were said in the Pollock case to have required apportionment; and the effect of the amendment was that the tax on income alone was freed from such apportionment, the tax on the real estate being still left subject to article I, section 9. Peck v. Lowe, 247 U.S. 165; Eisner v. Macomber, 252 U.S. 189; Evans v. Gore, 253 U.S. 245. The amendment "confers no power upon Congress to define and

tax as income without apportionment something which theretofore could not have been properly regarded as income", Taft v. Bowers, 278 U.S. 470.

Thus the only theory upon which a tax on the rental value of real estate occupied by the owner could be laid without apportionment would be that such rental value is income within the legal signification of that term as used in the sixteenth amendment. That it may be sometime regarded as income by economists some of whom may use the term as applying to benefits or enjoyments is not controlling, Lynch v. Turrish, 247 U.S. 221; Merchants Loan & Trust Co. v. Smietanka, 255 U.S. 509. Nor may we look to the use and
39 meaning of the word income found in statutes of several of the States, for the same constitutional requirements do not exist to give force to the limitations of definition. Here the restriction upon Congress is that it may not use or define the term so as to bring about an unapportioned direct tax, and no authority can be attached to a usage free from a similar restriction. The English usage to exclude profits from capital sales were disregarded in Merchants Loan & Trust Co. v. Smietanka, supra; and the Massachusetts usage to include stock dividends was disregarded in Eisner v. Macomber, supra. In the 1894 act, which was the precursor of the sixteenth amendment, rents were included, but no reference was made to rental value, and, as we have seen, the Pollock case took as a postulate that the use and value of realty was the realty itself rather than the income therefrom. The Corporation Excise Tax Act of 1909 used income in the same sense as a measure of excise tax, Flint v. Stone Tracy Co., 220 U.S. 107. Therefore there is nothing in the history immediately preceding the sixteenth amendment to give support to a more expansive use of the word income than that considered in the Pollock case. And clearly nothing can be said for treating rents—which indubitably are income—as including rental value of space owned and occupied. Rent has since feudal times implied two separate persons and estates, those of landlord and tenant, and it would be a misnomer to apply it to the value of a landlord's use and occupancy of his own property. Thompson on Real Property; Tiffany on Real Property; 36 Corpus Juris 285. See also Duffy v. Central R.R., 268 U.S. 55.

It seems to us furthermore that a construction of income to include rental value of occupancy of realty by its owner would be to narrow the force of the requirement of apportionment to a point of practical nullification.

"A proper regard for its genesis, as well as its very clear language, requires also that this amendment shall not be extended by
40 loose construction, so as to repeal or modify except as applied to income, those provisions of the Constitution that require an apportionment according to population for direct taxes upon property, real and personal. This limitation still has an appropriate and important function and is not to be overridden by Con-

gress or disregarded by the courts." Eisner v. Macomber, 252 U.S. 189, 206.

Since, as we have seen, to tax the use or value of realty as distinguished from rents or profits is to tax the realty itself, it would result that although the requirement of apportionment would nominally remain applicable to a tax imposed eo nomine upon the realty itself, still a tax in the same measure upon rental value of realty occupied by the owner would escape apportionment. The speciousness of such a differentiation is obvious.

"If it be true that by varying the form the substance may be changed, it is not easy to see that anything would remain of the limitations of the Constitution or of the rule of taxation and representation so carefully recognized and guarded in favor of the citizens of each State. But constitutional provisions cannot be thus evaded." * * * Pollock v. Farmers Loan & Trust Co., 157 U.S. 429, 581.

The use and meaning of the word income at the time of its incorporation in the sixteenth amendment has been considered by the Supreme Court in several cases since the amendment with an effect consistent, we think, with our understanding and with sufficient applicability to the present problem to be binding upon us.

In Stratton's Independence v. Howbert, 231 U.S. 399, decided December 1, 1913, the question arose under the Corporation Tax Act of 1909 whether income, which measured the tax, included the proceeds of mining operations, and the court said:

> Income may be defined as the gain derived from capital, from labor, or from both combined.

41 See Doyle v. Mitchell Bros. Co., 247 U.S. 179. This definition has been applied to the amendment and to the later income-tax acts under it. In Eisner v. Macomber, supra, the Court expounded the definition so as to make it clear that the gain must be more than a mere increment or appreciation of value within the capital property. It must be "something of exchangeable value proceeding from the property, severed from the capital, however invested or employed, and coming in, being derived—that is received or drawn by the recipient (the taxpayer) for his separate use, benefit, or disposal—that is income derived from property." This was said in order to demonstrate that a stock dividend was not income, although by the receipt of new certificates a stockholder might deal separately to some extent with his increment. As to stock rights, the Court held similarly in Miles v. Safe Deposit & Trust Co., 259 U.S. 247, and said:

"The right to subscribe to the new stock was but a right to participate, in preference to strangers and on equal terms with other existing stockholders, in the privilege of contributing new capital called for by a corporation—an equity that inheres in stock ownership under such circumstances as a quality inseparable from the capital interest represented by the old stock, recognized so uni-

versally as to become axiomatic in American corporation law. * * *"

In Goodrich v. Edwards, 255 U.S. 527, the taxable gain derived from a sale of capital assets (Merchants Loan & Trust Co. v. Smietanka, 255 U.S. 509) was confined to the excess over original investment despite a lower value of March 1, 1913. This was because the Constitution required it. Lucas v. Alexander, U.S. A subsidy was held to be capital contribution by the State and not a gain, Edwards v. Cuba R.R. Co., 268 U.S. 628, and a mathematical gain was excluded from the definition where it was incidental to an actual loss, Bowers v. Kerbaugh-Empire Co., 271 U.S. 170. The importance of separation was manifested in Taft v. Bowers, 278 U.S.
42 470, holding the donee of stock who sells for a price in excess of his donor's cost taxable upon the gain. The Court said:

"In truth the stock represented only a single investment of capital—that made by the donor. And when through sale or conversion the increase was separated therefrom, it became income from that investment in the hands of the recipient subject to taxation according to the very words of the sixteenth amendment. * * *"

While these several decisions deal with problems specifically different from the one at bar, they indicate a tacit recognition that income is more than mere use or enjoyment of one's own property in its original form. There must be some sort of consumated pecuniary gain from which the tax can be paid. We find no intimation that rental value of property occupied may be regarded as income any more now than at the time of the decision in the Pollock case. This being inherent in the Constitution itself, Congress is precluded from broadening the meaning by legislation.

"In order therefore that the clauses cited from article I of the Constitution may have proper force and effect, save only as modified by the amendment, and that the latter also may have proper effect, it becomes essential to distinguish between what is and what is not 'income', as the term is there used, and to apply the distinction, as cases arise, according to truth and substance, without regard to form. Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised." Eisner v. Macomber, 252 U.S. 189.

"It is true that Congress cannot make a thing income which is not so in fact." Burk-Waggoner Oil Association v. Hopkins, 269 U.S. 110.

See also Taft v. Bowers, supra.

43 The next question, assuming it to be established that rental value of space occupied by the owner may not be included in his income directly, is whether there is nevertheless the power to say that no deduction shall be allowed of taxes, expenses, and depreciation unless such rental value is included in gross income. A tax

upon such rental as income without apportionment being prohibited, the inquiry is similar to that discussed in Evans v. Gore, 253 U.S. 245; Miles v. Graham, 268 U.S. 501; and National Life Insurance Co. v. United States, 277 U.S. 508. A Federal judge's salary, being protected from diminution, may not be required to be included in gross income, Evans v. Gore, supra.

If the tax in respect of his compensation be prohibited, it can find no justification in the taxation of other income as to which there is no prohibition; for, of course, doing what the Constitution permits gives no license to do what it prohibits.

* * * * * * * * *

* * * The taxing act directs that the compensation—the full sum, with no deductions for expenses—be included in computing the net income, on which the tax is laid. If the compensation be the only income, the tax falls on it alone; and, if there be other income, the inclusion of the compensation augments the tax accordingly. In either event the compensation suffers a diminution to the extent that it is taxed.

In Miles v. Graham, supra, applying the rule of Evans v. Gore to judges of the Court of Claims, the Supreme Court said:

"No judge is required to pay a definite percentage of his salary, but all are commanded to return, as a part of 'gross income' the compensation received as such from the United States. From the gross income various deductions and credits are allowed, as for interest paid, contributions or gifts made, personal exemptions varying with family relations, etc., and upon the net result assessment is made. The plain purpose was to require all judges to return
44 their compensation as an item of 'gross income' and to tax this as other salaries. This is forbidden by the Constitution."

The recent decision in National Life Insurance Co. v. United States, supra, is still more pertinent in its analogy. There, as here, the Constitution protected a subject from tax under the sixteenth amendment—there, interest from certain securities; here rental value of space occupied. In both cases a deduction was limited by reason of the protected subject, the deduction there being that of 4 percent of the reserves, and here of taxes, expenses, and depreciation. The argument for the validity of the statute was made there, as here, that as the deduction was not essential, its limitation was discretionary. Without deciding whether a deduction for taxes, expenses, and depreciation in respect of real estate is essential to the computation of net income where the rents received are included in the gross (cf. Von Baumbach v. Sargent Land Co., 242 U.S. 503; Doyle v. Mitchell Bros. Co., 247 U.S. 179; United States v. Anderson, 269 U.S. 422; United States v. Ludey, 274 U.S. 295), it can safely be said that it is no less so than that of a percentage of reserves to life insurance companies, and for present purposes the situation is therefore similar. We quote from the opinion:

"The portion of petitioner's income from the three specified sources which Congress had power to tax—its taxable income—was the sum of these items less the interest derived from tax-exempt securities. Because of the receipt of interest from such securities, and to its full extent, pursuing the plan of the statute the collector diminished the 4 percent deduction allowable to those holding no such securities. Thus, he required petitioner to pay more upon its taxable income than could have been demanded had this been derived solely from taxable securities. If permitted this would destroy the guaranteed exemption. One may not be subjected to greater burdens upon his taxable property because he owns some that
45 is free. No device or form of words can deprive him of the exemption for which he has lawfully contracted.

The suggestion that, as Congress may or may not grant deductions from gross income at pleasure, it can deny to one and give to another, is specious but unsound. The burden from which Federal and State obligations are free is the one laid upon other property. To determine what this burden is requires consideration of the mode of assessment, including, of course, deductions from gross values. What remains after subtracting all allowances is the thing really taxed."

* * * * * * *

Congress had no power purposely and directly to tax State obligations by refusing to their owners deductions allowed to others.

We are thus compelled by authority to reach the conclusion that the inclusion in gross income of rental value of space occupied by the taxpayer in its own building for tax without apportionment, as a condition of the deduction of any taxes, depreciation, or expenses, is forbidden. It should not be overlooked that the condition of paragraph (b) is not applicable alone to such amount of the deductions under (6) and (7), as compares with space occupied, but operates as a condition of such deductions in any amount in respect of the whole building. Unless the taxpayer returns as gross income the rental value of the one story occupied, it may not have any deductions whatever of the charges applicable to any part of the building, notwithstanding all rents received are returnable. The alternative given is to pay tax on gross rents received without deduction or to pay tax on net rents received plus rental value of space occupied. This, we think, is subject to at least the objection stated by the Supreme Court in the National Life Insurance Co. case, and is consequently an invalid provision.

It is important, however, that the other objections to paragraph (b) should be considered since it is quite conceivable that the foregoing may in some respect be found wanting, and the importance of an issue under the Constitution justifies a broad inquiry and requires the fullest consideration. Assuming, therefore, that
46 the first sentence of the paragraph is beyond attack, so that

true rental value of space occupied is properly required to be included in gross income, the next inquiry is as to the validity of the second sentence. By this, as has been seen, it is provided that no figure will be recognized as rental value of space occupied which is less than enough to bring about, with net rents received, a net income from the building of 4 percent of its book value. The mathematical operation of this provision in the case at bar has been already set forth. For 1923 it brought about a figure of $14,784.70 as the rental value of one story, to be added to $73,620.48 from tenants for eleven stories; for 1924, rental value of the same one story was computed at $34,400.08, as compared with $71,289.21 received for the remainder. Although the rents received were diminished from 1923 to 1924, and the charges increased from $70,905.18 to $85,918.87, giving an apparent indication of reduced rental value of space in the building, the required formula forces an increased rental value of the story occupied to more than double. Whether this is typical of the application of the statute or unique does not appear. It is the actual situation as to this taxpayer brought about by the plain requirement of the statute, and to him it cannot be said that it is an extreme illustration. As to 1924, it results in a tax based upon artificial income whereas in fact there has been a loss. Being unable to derive 4 percent net income from the building, petitioner is nevertheless required to construct its tax return so that it will be taxed as if it did.

It seems clear that such a tax is not upon income, but its effect is to tax the realty itself, and what we have said as to the use of actual rental value in gross income is more forcibly true as to such a forced minimum. A 4 percent income from an insurance building may approximate an actual or average return (and we should perhaps assume that Congress so regarded it), but it is not true income within the sixteenth amendment unless it has in fact been derived from the property or capital invested. To base the tax upon the assumption that it was in fact realized, irrespective of whether it was or not,

is not the power granted by the sixteenth amendment; and
47 since this is the only authority under which Congress *ed* assumed to act in title II, it must fail of its purpose and be held invalid.

What we have said as to the use of the artificial 4 percent minimum is likewise true of the use of book value as its basis. How book value in any given case may be arrived at or what it means is not set forth in the statute, and whether it has a meaning as to life insurance companies sanctioned by law does not appear. Regulations 62, issued under the Revenue Act of 1921, treat the accounts of life insurance companies as uniform. But bookkeeping entries are not conclusive, Doyle v. Mitchell Bros. Co., supra, and the book value of property is not to be taken as actual value, Virginia v. West Virginia, 238 U.S. 202. Thus to take book value as the standard upon which the percentage return is to be measured is to depart from fact, and just so far to define income beyond its true bounds. And

we say this, even assuming that the particular book value represents actual cost with proper adjustments for wear and tear, etc., for if the investment has proved ill-advised the actual value may be far below cost and a 4 percent return on book value may be impossible to derive.

"It is urged that the book value represents actual value where books are correctly kept. This is not necessarily true, as books may be said to be correctly kept, in a sense, when they truly state the items set forth. But cost carried forward may not be the same as present value. Despite repairs and renewals, a suitable allowance for depreciation may not have been made. It would be too much to say that there is any controlling presumption * * *.

* * * * * * *

"On the other hand, in the absence of a more complete showing with respect to the physical property and its condition, the expenditures for maintenance and the extent of depreciation, it is wholly impossible to say that the book cost represented the actual value at the time to which the inquiry was addressed. Book cost, as we have said, would be a more or less doubtful criterion." Virginia v. West Virginia, 238 U.S. 202.

Thus we are driven to the conclusion, despite the presumption to the contrary, that paragraph (b), although correctly construed and applied by respondent, invades this petitioner's constitutional rights.

48. Our decision, therefore, is that the deficiency is invalid insofar as it results from the inclusion in gross income of any figure representing rental value of the space occupied by petitioner in its building.

Reviewed by the Board.

Judgment will be entered under Rule 50.

Dissenting opinion

MARQUETTE, dissenting: The opinion herein holds that "the respondent has correctly construed the statute and that the deficiencies determined are in accordance therewith." When the Board reaches such a conclusion I believe it has exhausted its powers, except to enter a judgment for the respondent. The opinion proceeds, however, to discuss the constitutionality of the statute and reaches the conclusion that it is unconstitutional. This, in my opinion, is a clear usurpation of a judicial function not possessed by this Board. I have had occasion heretofore, in Henry Cappellini, 14 B.T.A. 1269, to express the idea that the power to declare an act of Congress unconstitutional is exclusively a judicial function; that no part of the judicial power of the United States, in a constitutional sense, is vested in this Board, and that the Board is without power to approach such a question. I am still of the same opinion. However persuasive the reasoning may be, or however logical the conclusion, it offers no excuse for the exercises of a power which we do

not possess. It seems to me that such a pronouncement is binding on no one, and I believe the respondent is entitled to collect the deficiency as determined by him.

MORRIS and VAN FOSSAN agree with the above dissent.

Now, Dec. 13, 1930, the foregoing findings of fact and opinion certified from the record as a true copy.

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

49 Before U.S. Board of Tax Appeals

Judgment

Entered November 18, 1929

Following the Board's report promulgated October 4, 1929 (17 B.T.A. 757), the respondent, under Rule 50, submitted a proposed judgment which petitioner agrees is in conformity with the said report. In accordance therewith it is

Ordered, adjudged, and decided that there is an overpayment of income tax for 1923 of $112.86 and for 1924 of $226.79.

Now, Dec. 13, 1930, the foregoing decision certified from the record as a true copy.

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

Before U.S. Board of Tax Appeals

Petition for review in the United States Circuit Court of Appeals and assignments of error

Filed May 13, 1930

Now comes Robert H. Lucas, Commissioner of Internal Revenue, by his attorneys, G. A. Youngquist, Assistant Attorney General, and C. M. Charest, general counsel, Bureau of Internal Revenue, and respectfully shows:

I

That he is the duly appointed, qualified, and acting Commissioner of Internal Revenue, appointed and holding his office by virtue of the laws of the United States; that the Independent Life Insurance Company of America is a corporation subject to the provisions of the Federal income tax laws, whose principal office is located in the city of Nashville, Tennessee, and whose returns for Federal income
50 tax purposes for the taxable years 1923 and 1924 were made to the collector of internal revenue for the district of Tennessee, whose office is located in Nashville, Tennessee, which is within the jurisdiction of the United States Circuit Court of Appeals for the Sixth Circuit.

II

That the nature of the controversy is a follows, to wit:

The taxpayer is a life insurance company which, during the years 1923 and 1924, was regularly engaged in the conduct of its business in the city of Nashville, Tennessee. It owned a twelve-story building located in said city, part of which it occupied as its own office, and part of which it rented to tenants.

In computing it net income for the taxable years 1923 and 1924, the taxpayer claimed deductions under the provisions of section 245 (a), 6 and 7 of the Revenue Acts of 1921 and 1924, said deductions being for taxes, expenses, and depreciation in respect to the entire building which it owned and in part occupied; but it did not include in gross income the rental value of said building as provided in section 245 (b) of said acts. The respondent allowed said deductions, but he included in the taxpayer's gross income the rental value of said office space. This resulted in tax deficiencies being determined for the taxable years 1923 and 1924 in the respective amounts of $298.97 and $1,115.65.

III

The taxpayer appealed from said determinations of the Commissioner to the United States Board of Tax Appeals. The Board held that the Commissioner had correctly construed the provisions of section 245 (b) of the Revenue Acts of 1921 and 1924, and had correctly determined the deficiencies in accordance therewith; but it held that said provisions of the statute were in conflict with the Constitution, and hence were invalid. It held that there were no deficiencies in tax for the years 1923 and 1924, but that there were overpayments for said years in the respective amounts of $112.86 and $226.79.

The hearing was held before the Board on January 29, 1929,
51 and the interlocutory decision of the Board, its findings of fact and opinion were promulgated October 4, 1929. The Board's final order of redetermination, adjudging that there were overpayments of tax for the years 1923 and 1924, was entered November 18, 1929.

IV

That the Commissioner, being aggrieved by the said decision of the Board of Tax Appeals and also by the said order of redetermination, desires to obtain a review of said decision and order by the United States Circuit Court of Appeals for the Sixth Circuit; and as reasons for such review, he alleges that the Board, in rendering its opinion and entering its final order of redetermination, committed the following errors:

1. The Board of Tax Appeals erred in determining that there were no deficiencies in the amounts of the taxpayer's income tax for the taxable years 1923 and 1924.

2. The Board erred in failing to approve the determinations made by the Commissioner that there were deficiencies in tax for the taxable years 1923 and 1924 in the respective amounts of $298.97 and $1,115.65.

3. The Board erred in determining that there were overpayments of tax made by the Commissioner for the taxable years 1923 and 1924.

4. The Board erred in holding that the rental value of office space owned and occupied by a life insurance company is not income under the sixteenth amendment to the Constitution, and may not properly be included in its gross income for income tax purposes.

5. The Board erred in concluding that a life insurance company may not properly be required to include in its gross income the rental value of real estate owned and occupied by it as a condition to the deduction to taxes, depreciation and expenses relative to said real estate.

6. The Board erred in concluding that the provisions of section 245 (b) of the Revenue Acts of 1921 and 1924 are in conflict with the Constitution.

7. The Board erred in disapproving deficiencies determined by the Commissioner which it found were properly computed in accordance with the provisions of the statute.

52 8. The Board erred in concluding that it had power to declare an act of Congress unconstitutional, and in refusing to follow the provisions of said act.

9. The Board erred in disregarding the published regulations of the Treasury Department relative to the Revenue Acts of 1921 and 1924, and also in disregarding the established practice of the Internal Revenue Bureau in admonishing said acts.

10. The Board erred in rendering an opinion and entering an order of redetermination which are contrary to the law.

Wherefore, the Commissioner petitions that said decision and order of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Sixth Circuit; that a transcript of the record be prepared in accordance with the law and the rules of said Court, and be transmitted to the Clerk of said Court for filing; and that appropriate action be taken to the end that the errors herein complained of may be reviewed and corrected by said Court.

(Signed) G. A. YOUNGQUIST,
Assistant Attorney General.
(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Of Counsel.
ALLIN H. PIERCE,
Special Attorney,
Bureau of Internal Revenue.

[*Duly sworn to by C. M. Charest, jurat omitted in printing.*]

53 Sworn and subscribed to before me this 12th day of May, 1930.

(Signed) MARCELLETTE M. TAYLOR,
Notary Public.

(My commission expires March 31, 1935.)

Before U.S. Board of Tax Appeals

Notice of petition for review

Filed May 17, 1930

To: Independent Life Insurance Company of America, Independent Life Building, 4th and Church Streets, Nashville, Tennessee.

To: James A. Newman, Esq., Independent Life Building, Nashville, Tennessee.

You, and each of you, are hereby notified that this office has today filed with the United States Board of Tax Appeals on behalf of the Commissioner of Internal Revenue, a petition seeking a review of the Board's decision in the above-entitled cause by the United States Circuit Court of Appeals for the Sixth Circuit, a copy of which petition is hereto attached and served upon you.

Dated at Washington, D.C., this 13th day of May, 1930.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

54 Receipt of the above and foregoing notice, together with a copy of the petition for review mentioned therein, is hereby acknowledged this 15th day of May, 1930.

(Signed) INDEPENDENT LIFE INS. CO.,
By PAUL ROBERTS, *Pres.*,
Taxpayer.

(Signed) JAMES A. NEWMAN,
Attorney for taxpayer.

Now, Dec. 13, 1930, the foregoing petition for review and notice of filing certified from the record as a true copy.

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

Before U.S. Board of Tax Appeals

Statement of evidence

Filed November 20, 1930

The sole evidence in this cause consists of a stipulation of facts, which was entered into by the attorneys for both parties, as follows:

Stipulation of facts

It is hereby stipulated and agreed by and between the parties to the above-entitled appeal, by their respective counsel:

(1) That the petitioner, Independent Life Insurance Company of America, is a life insurance company, with its home office located at Nashville, Tennessee.

(2) That on January 25, 1927, the respondent mailed to the petitioner a notice of deficiency showing proposed deficiencies for the calendar years 1923 and 1924 in the amounts of $298.97 and $1,115.65, respectively. A copy of said notice of deficiency is attached hereto as exhibit A, it being agreed that the book value of
55 petitioner's building for the years 1923 and 1924 and the amounts shown therein as rents received from other tenants covering space occupied by others than the company are correct and the facts in this case.

(3) That during the years 1923 and 1924 the petitioner owned a twelve-story building located in the city of Nashville, Tennessee. The petitioner in 1923 and 1924 occupied about one story of said building as its home office and rented such portions of the remainder of the building as it was able to secure tenants for.

(Signed) JAS. A. NEWMAN,
Counselor for Petitioner.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Exhibit "1" to stipulation of facts

INDEPENDENT LIFE INSURANCE COMPANY. JAN. 25, 1927.
Independent Life Building,
Corner Fourth and Church Streets,
Nashville, Tennessee.

SIRS: The determination of your income-tax liability for the years 1923 and 1924, as set forth in office letter dated October 30, 1926, has been changed as the result of your letter dated November 26, 1926, to disclose a deficiency in tax amounting to $1,414.62, as shown in the attached statement.

STATEMENT

IT:CA:2553-9-60D

In re: Independent Life Insurance Company, Independent Life Building, Corner Fourth and Church Streets, Nashville, Tennessee

Year:	Deficiency in tax
1923	$298.97
1924	1,115.65
Total	$1,414.62

56

1923	
Income:	
Interest from all sources	$19,794.81
Rents	88,405.18
Gross income	$108,199.99

1923—Continued

Deductions:		
Interest exempt	$1,948.32	
Excess of 4% of mean of reserve over exempt interest	20,363.33	
Investment expenses	1,946.00	
Taxes	11,147.72	
Other real-estate expenses	51,357.46	
Depreciation	7,500.00	
Interest	8,552.48	
Total deductions		$102,815.31
Adjusted net income		$5,294.68

In connection with the above adjustment of gross income with respect to rents, your attention is invited to article 686, Regulations 62, which reads in part as follows:

"No deduction shall be made for any taxes, expenses, or depreciation on account of any real estate owned or occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied, such rental value shall not be less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation and other expenses) at the rate of 4 percent per annum of the book value at the end of taxable year on the real estate so owned and occupied."

Book value of home office			$460,000.00
Rents received from other tenants		$73,620.48	
Less:			
Expenses	$51,357.46		
Taxes (on R.E.)	11,147.72		
Depreciation	7,500.00		
		70,005.18	
		$3,615.30	
Less: 4% of $46,000.00		18,400.00	
57 Value of space owned and occupied by company to be included in gross income			14,784.70
Rents from other tenants in building in which company occupied space			73,620.48
Total rents to be reported in gross income			88,405.18

You are advised that the amount, $11,376.81, representing permanent improvements has been eliminated from expenses in accordance with section 245 (a) (6) of the Revenue Act of 1921.

COMPUTATION OF TAX

Net income	$5,294.68	
Less: Exemption	2,000.00	
Taxable at 12½%	3,294.68	
Tax at 12½%		$411.83
Previously assessed		212.86
Deficiency in tax		298.97

1924

Income:		
Interest from all sources		$20,519.85
Rents		105,689.29
Gross income BS:3		126,209.14
Deductions:		
Interest exempt	$1,687.81	
Excess of 4% of mean of reserve over exempt interest	22,773.76	
Investment expenses	2,220.34	
Taxes	11,147.00	
Other real estate expenses	67,271.97	
Depreciation	7,500.00	
Interest	868.69	
Total deductions		113,469.57
Adjusted net income		12,739.57

The adjustment for rents is made for the same reason as given in 1928. The computation is as follows:

Book value of home office			$494,257.97
Rents received from other tenants		$71,289.21	
58 Less:			
Expenses	$67,271.97		
Taxes (on R. E.)	11,147.00		
Depreciation	7,500.00		
		85,918.97	
		14,629.76	
Add: 4% of $494,237.97		19,770.32	
Value of space owned and occupied by company to be included in gross income			34,409.08
Rents from other tenants in building in which company occupied space			71,289.21
Total rents to be included in gross income			105,689.29

COMPUTATION OF TAX

Net income	$12,739.57
Less: Exemption	2,000.00
Taxable at 12½%	10,739.57
Tax at 12½%	1,342.44
Previously assessed	226.79
Deficiency in tax	1,115.65

Your return for the year 1922 has been closed, showing no tax liability.

You are advised that the contentions contained in your letter dated November 26, 1926, have been allowed with the exception of permanent improvements included in expenses for 1928.

Payment of the tax should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him.

The petitioner on review submits the foregoing as a true and correct statement of all of the evidence which was submitted to the

United States Board of Tax Appeals, and prays that the same may be approved and filed as a part of the record in this cause.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue,
Attorney for Petitioner on Review.

59 Approved:

(Signed) JAMES A. NEWMAN,
Attorney for Respondent on Review.

Order approving statement of evidence

The foregoing statement of evidence is a true and complete statement of all of the evidence adduced before the United States Board of Tax Appeals in the above-entitled cause. Said statement is hereby approved, signed, and ordered to be made a part of the record in said cause this 20th day of November 1930.

(Signed) J. M. STERNHAGEN,
Member, United States Board of Tax Appeals.

Now, Dec. 13, 1930, the foregoing statement of evidence certified from the record as a true copy.

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

Before U.S. Board of Tax Appeals

Praecipe for transcript of record

Filed Nov. 19, 1930

To the Clerk of the United States Board of Tax Appeals:

You are hereby requested to prepare a transcript of the record in this cause, in due time, transmit the same to the clerk of the United States Circuit Court of Appeals for the Sixth Circuit. You are requested to include in said transcript, duly certified as correct, the following documents:

1. Docket entries of the proceedings before the Board.
2. Pleadings before the Board, including amended petition for redetermination and answer to said amended petition.
3. Motion to amend petition, copy of amendment tendered, and order allowing the amendment.

60 4. Findings of fact, opinion, and decision of the Board.

5. Petition for review, and proof of service thereof.
6. Statement of evidence as settled or agreed upon.
7. This praecipe.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue,
Attorney for Petitioner on Review.

Service of the foregoing praecipe and receipt of a copy of the same is acknowledged this 15th day of November 1930. No objection will be filed with respect to the same.

JAMES A. NEWMAN,
Attorney for Respondent on Review.

Now, Dec. 13, 1930, the foregoing praecipe certified from the record as a true copy.

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

Before U.S. Board of Tax Appeals

Order enlarging time

Upon motion of counsel for petitioner, it is

Ordered: That the time for preparation of the evidence and for transmission and delivery of the record *sur* petition for review of the above-entitled proceeding in the United States Circuit Court of Appeals for the Sixth Circuit be, and hereby is, extended to October 1, 1930.

(Signed) LOGAN MORRIS,
Member.

Dated, Washington, D.C., July 14, 1930.

A true copy:

Teste:

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

61 Before U.S. Board of Tax Appeals

Order enlarging time

Upon motion of counsel for petitioner, it is

Ordered: That the time for preparation of the evidence and for transmission and delivery of the record sur petition for review of the above entitled proceding in the United States, Circuit Court of Appeals for the Sixth Circuit be, and it is hereby, extended to November 15, 1930.

(Signed) PERCY W. PHILLIPS,
Member.

Dated, Washington, D.C., October 1, 1930.

A true copy:

Teste:

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

Before U.S. Board of Tax Appeals

Order enlarging time

Upon motion of counsel for petitioner, it is

Ordered: That the time for preparation of the evidence and for transmission and delivery of the record sur petition for review of the above-entitled proceeding in the United States Circuit Court of Appeals for the Sixth Circuit be, and it is hereby, extended to Dec. 15, 1930.

(Signed) LOGAN MORRIS,
Member.

Dated, Washington, D.C., November 15, 1930.

A true copy:

Teste:

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

62 *Order enlarging time*

For cause appearing of record, it is

Ordered: That the time for transmission and delivery of the record sur petition for review of the above entitled proceedings in the United States Circuit Court of Appeals for the Sixth Circuit be, and it is hereby, extended to January 31, 1931.

(Signed) LOGAN MORRIS,
Member.

Dated, Washington, D.C., Dec. 15, 1930.

A true copy:

Teste:

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

63 In United States Circuit Court of Appeals for the Sixth Circuit

Cause argued and submitted

Jan. 12, 1932

Before HICKS, HICKENLOOPER, and TUTTLE, J.

This cause is argued by Helen R. Carloss for petitioner and by James A. Newman for respondent and is submitted to the Court.

64 (File indorsement omitted.)

In United States Circuit Court of Appeals, Sixth Circuit

No. 5850

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

THE INDEPENDENT LIFE INSURANCE COMPANY, RESPONDENT

Petition to review an order of United States Board of Tax Appeals

Certificate of questions filed

December 14, 1932

Before HICKS and HICKENLOOPER, circuit judges, and TUTTLE, district judge.

PER CURIAM: This cause involves the construction and proper scope of sections 243, 244, and 245 of the Revenue Act of 1921, c. 136, 42 Stat. 227, and the Revenue Act of 1924, c. 234, 43 Stat. 253, and the validity of section 245 (b) of said acts.

The respondent is a life-insurance company. During the years 1923 and 1924 it owned a twelve-story building, occupying one story and renting portions of the remainder. In making its income-tax returns for the years 1923 and 1924 it deducted from its gross income from this building taxes, expenses, and an allowance for depreciation, as provided in section 245 (a) (6) and (7) of the applicable acts, but it did not include in its gross income the rental value of the space occupied by it as required by section 245 (b) of each act, such value to be an amount which, added to the rents received from other tenants, would provide a net income, after proper deductions, equal to 4% of the book value of the building.

The Commissioner determined a deficiency for the year 1923 in the sum of $298.97, and for the year 1924 in the sum of
65 $1,115.65, upon the hypothesis that if taxes and other expenses paid during the taxable year exclusively upon or with respect to real estate owned by the company and occupied in whole or in part by it, and a reasonable allowance for depreciation, be deducted under section 245 (a) (6) and (7), the company must include in its return of gross income the rental value of space which it occupied, at the rates specified in section 245 (b). The respondent appealed to the Board of Tax Appeals, and the Board found that the deficiencies for the two years were calculated in accordance with section 245 (b) of the respective acts, but that these sections violated the Constitution of the United States (art. I, sec. 2, cl. 3, and art. I, sec. 9, cl. 4) upon the theory that a tax upon such purely hypothetical rental value was not an income tax, but a direct tax upon real estate without apportionment. The Commissioner thereupon brought the present petition to review.

Upon the foregoing facts, we certify to the Supreme Court of the United States the following questions of law, concerning which we desire instructions for the proper decision of this cause:

(1) Are the provisions of section 245 (b) of the Internal Revenue Acts of 1921 and 1924 valid and constitutional enactments, and enforceable in respect of the minimum rental values therein prescribed?

(2) If the first question be answered in the negative, was the respondent estopped to so claim by reason of having deducted taxes, expenses, and allowance for depreciation in respect of its building when making its returns for the years 1923 and 1924?

XEN HICKS,
United States Circuit Judge.
SMITH HICKENLOOPER,
United States Circuit Judge.
ARTHUR J. TUTTLE,
United States District Judge.

For such convenience, if any, as it may be to the Supreme Court, we state briefly the conflicting considerations, developed by our study, which have led us to certify.

The record shows that the respondent occupied but one story of the twelve-story building owned by it; that the home office building had a book value of $460,000 at the close of the 1923 taxable year; that rents received from other tenants amounted to $73,620.46 for that year, and expenses, taxes, and depreciation to the sum of $70,005.18, making the value of the space occupied by the company to be included in gross income, if the method prescribed by section 245 (b) were followed, $14,784.70. For the year 1924 the book value of the home office building was found to be $494,257.97, the rents received from other tenants $71,289.21, and expenses, taxes, and depreciation, $85,918.97. For the year 1924, therefore, there was an actual loss in the operation of the building, excluding the rental value of space occupied by the company, of $14,629.76, due to slightly decreased receipt of rentals from other tenants and substantial increases in the expense of operation, and the value of the space occupied by the company to be included in gross income was increased, if the method of computation provided in section 245 (b) were followed, to the sum of $34,400.08, or almost $20,000 in excess of the value placed upon the same space for the previous year.

In one view, it may seem that the adoption of the sixteenth amendment did not in any wise limit the power of Congress to levy an excise tax upon the conduct of business in a corporate capacity (Cf. Eisner v. Macomber, 252 U.S. 189); that the present tax may be properly regarded as an excise tax measured by income as defined in the acts (Cf. Burnet v. Thompson Oil & Gas Co., 283 U.S. 301; Stanton v. Baltic Mining Co., 240 U.S. 103; Stratton's Independence, Ltd., v. Howbert, 231 U.S. 399); that permissible deductions

from gross income are purely statutory (Burnet v. Thompson Oil & Gas Co., supra); and that the company having accepted the act by continuing to do business in corporate form, and by claiming deductions for expenses, taxes and depreciation, is estopped to assail the provisions of section 245 (b) (Cf. Shepard v. Barron, 194 U.S. 553, 557; Pullman Co. v. Kansas [concurring opinion of Mr. Justice White], 216 U.S. 56, 66; Horn Silver Min. Co. v. New York, 143 U.S. 305, 313; Pierce Oil Co. v. Phoenix Ref. Co., 259 U.S. 125, 128; Grand Rapids & Ind. Ry. Co. v. Osborn, 193 U.S. 17, 29; Daniels v. Tearney, 102 U.S. 415; Oakland Sugar Mill Co. v. Fred W. Wolf Co., 118 Fed. 239, 244, C.C.A. 6; B. & O. R. Co. v. Lambert Run Coal Co., 267 Fed. 776, 781, C.C.A. 4; Owens v. Corporation Comm'n. of Okla., 41 Fed. [2] 799, 803, D.C.).

In the other view, it is to be observed that the Internal Revenue Acts of 1921 and 1924 do not purport to levy true excise taxes,
67 but the tax so levied by Section 243 is expressly declared to be "upon the net income of every life insurance company." In this view it may seem that section 245 (b) requires the inclusion in gross income of that which is not income; "that Congress cannot make a thing income which is not so in fact" (Burk-Waggoner Ass'n. v. Hopkins, 269 U.S. 110, 114; Taft v. Bowers, 278 U.S. 470, 481), and that it may validly tax under the sixteenth amendment only that which is within the definition of income as repeatedly announced by the Supreme Court (Bowers v. Kerbaugh-Empire Co., 271 U.S. 170; Eisner v. Macomber, supra), or, at least, that Congress has here in fact taxed only income or "gain" (Goodrich v. Edwards, 255 U.S. 527; Lynch v. Turrish, 247 U.S. 221); that a tax upon real estate or a tax upon the income therefrom is a direct tax which could not be laid without apportionment among the States except for the adoption of the sixteenth amendment (Pollock v. Farmers Loan & Trust Co., 157 U.S. 429, 580, 581; Brushaber v. Union Pacific R. Co., 240 U.S. 1); and that the case of National Life Ins. Co. v. United States, 277 U.S. 508, refutes both the contention that the taxes in question should properly be considered excise taxes measured by income, and, at page 520, the contention that since Congress may or may not grant deductions from gross income at pleasure, it can deny such deductions to one and give it to another.

In this view it is also to be noted that Congress has not attempted to require simply that the rental value of space occupied by an insurance company in its own building shall be returned as income, thus equalizing the burden of taxation as between companies owning their own office buildings and those companies which rent office space and which are not allowed deductions for the rentals so paid, but has provided an arbitrary and capricious method, as is claimed, for the ascertainment of such rental value, illustrated in the present case by an increase in rental value for the same space of more than 100% for the year 1924 over that fixed for 1923.

68 In United States Circuit Court of Appeals

Mandate of the Supreme Court

Filed April 3, 1933

UNITED STATES OF AMERICA, *ss:*

The President of the United States of America

To the honorable the Judges of the United States Circuit Court of Appeals for the Sixth Circuit, greeting:

Whereas, lately in the United States Circuit Court of Appeals for the Sixth Circuit, in a cause between Commissioner of Internal Revenue, petitioner, and the Independent Life Insurance Company, respondent, no. 5850, wherein certain questions of law arose which were certified by the said Circuit Court of Appeals to the Supreme Court of the United States for its opinion; as by the inspection of the certificate of the judges of the said United States Circuit Court of Appeals which was brought into the Supreme Court of the United States agreeably to the act of Congress, in such case made and provided, fully and at large appears.

And whereas, in the present term of October, in the year of our Lord one thousand nine hundred and thirty-two of the said Supreme Court, counsel for the Independent Life Insurance Company filed a motion to bring up the entire record and cause herein,

On consideration whereof, It is ordered by this court that the said motion be, and the same is hereby, denied.

69 And it is further ordered, That the certificate herein be, and the same is hereby, dismissed.

February 20, 1933.

You, therefore, are hereby commanded that such proceedings be had in such cause, as according to right and justice, and the laws of the United States, ought to be had, the said certificate notwithstanding.

Witness, the honorable CHARLES E. HUGHES, Chief Justice of the United States, the first day of April, in the year of our Lord one thousand nine hundred and thirty-three.

CHARLES ELMORE CROPLEY,
Clerk of the Supreme Court of the United States.

File No. 35259. Supreme Court of the United States, no. 562. October Term, 1932. Commissioner of Internal Revenue, vs. The Independent Life Insurance Company. Mandate.

70 In United States Circuit Court of Appeals

Order setting case for reargument

Filed April 4, 1933

It is ordered that this cause be specially set for reargument on Tuesday, May 9th, 1933.

In United States Circuit Court of Appeals

Cause reargued and submitted

May 9, 1933

Before: HICKS, HICKENLOOPER, and TUTTLE, JJ.

This cause is reargued by J. L. Monarch for petitioner and by J. A. Newman for respondent and is submitted to the court.

In United States Circuit Court of Appeals

Decree

Filed Nov. 10, 1933

APPEAL from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, It is now here ordered, adjudged, and decreed by this court that the order or decree of the said Board of Tax Appeals in this cause be and the same is hereby, affirmed.

71 (File endorsement omitted.)

In United States Circuit Court of Appeals, Sixth Circuit

No. 5850

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

THE INDEPENDENT LIFE INSURANCE COMPANY, RESPONDENT

Petition to review an order of the United States Board of Tax Appeals

Opinion filed

November 10, 1933

Before HICKS and HICKENLOOPER, Circuit Judges, and TUTTLE, District Judge.

HICKS, Circuit Judge: Petition by the Commissioner of Internal Revenue to review an order of the Board of Tax Appeals adjudging

that respondent had overpaid its income taxes for the years 1923 and 1924 in the sums of $112.86 and $226.79, respectively.

Respondent is a life insurance company, and during the years 1923 and 1924 owned a twelve-story building, occupying one story and renting portions of the remainder.

The Commissioner determined a deficiency in respondent's taxes for the year 1923 in the sum of $298.97 and for the year 1924 in the sum of $1,115.65. These alleged deficiencies grew out of the following facts.

Although respondent had deducted for each year taxes, expenses, and an allowance for depreciation incurred in connection with its building, as provided in sec. 245 (a) (6) and (7) of the Revenue Acts of 1921 and 1924, it had not included in its returns of gross income for those years the rental value of the space occupied by it as required by sec. 245 (b) of each act. Sec. 245 (b) of the act of 1921 is printed in the margin.[1] Sec. 245 (b) of the act of 1924 is similar.

By the provisions of these sections, as interpreted by article 686 of Treasury Regulation 62, under the Revenue Act of 1921, and Treasury Regulation 65, under the Revenue Act of 1924, the Commissioner included in respondent's gross income $14,784.70 for 1923, and $34,400.08 for 1924, as the rental value of the space occupied by respondent in its building for those years. His action gave rise to the deficiencies complained of.

The Board found that the deficiency for each year was calculated in accordance with sec. 245 (b) as it appears, respectively, in the Revenue Acts of 1921 and 1924, but that the requirement thereof, for the inclusion in gross income of the rental value of the space occupied by respondent in its building, violated the Constitution (art. 1, sec. 2, clause 3; and art 1, sec. 9, clause 4) upon the theory that a tax upon such rental value was not an income tax but a direct tax upon real estate without apportionment.

Petitioner insists that sec. 245 (b) of each act was constitutional and that the Board was unauthorized to declare otherwise.

The court is not concerned with whether the Board of Tax Appeals was authorized to pass upon the constitutionality of these enactments. A decision by us upon that question would not decide this case. We are, however, required to consider and determine whether the decision of the Board that respondent had overpaid its income taxes for the years involved was "in accordance with law." *Revenue Act of 1926*, ch. 27, sec. 1003; *Commissioner* v. *Liberty Bank & Trust Co.*, 59 Fed. (2) 320, 324 (C.C.A. 6). In the discharge of this duty the court is called upon to determine for itself whether

[1] "Sec. 245 (b). No deduction shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate owned and occupied in whole or in part by a life insurance company, unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied."

section 245 (b), of the acts of 1921 and 1924 respectively was a valid enactment. *Smythe* v. *Ames*, 169 U.S. 526. If it was not, the finding of the Board, which may be construed as a finding that no additional tax was due, would obviously have been correct, regardless of the power of the Board to pass upon the constitutionality of the act of Congress.

73 Prior to the Revenue Act of 1921 (ch. 136, 42 stat. 227) life insurance companies were classed, for income tax purposes, with ordinary corporations. They were required to report income from all sources with certain minor exceptions not here important. This included income from premium receipts commonly called underwriting income. The inclusion of premium receipts in gross income was found to be unsatisfactory both to the Government and to the companies because these receipts did not always represent true income. See dissenting opinion of Mr. Justice Brandeis in National Life Ins. Co. v. United States, 277 U.S. 508, 522, 523. With the approval of "Life Insurance Presidents" at their annual meeting in December 1920, Congress provided for the assessment of income taxes against insurance companies upon a new basis, embodied in sections 243, 244(a), 245 (a) and (b) of the Revenue Act of 1921, ch. 136, 42 stat. 227. Sec. 243 provides that "there shall be levied, collected, and paid for the calendar year 1921 and for each taxable year *thereafter upon the net income of every life insurance company a tax as follows* . . . ." (Italics ours.)

Sec. 244 (a) provides that the term "gross income" means the gross amount of income received during the taxable year from *interest, dividends, and rents.* (Italics ours.) Sec. 245 (a) provides the method for the determination of "net income." The pertinent provisions of section 243, 244 (a), and 245 (a) are similar in the acts of 1921 and 1924, respectively. In determining, therefore, whether the rental value of the space occupied by the life insurance company in its own building should be included in the return of gross income, an accurate conception of the terms, "income", "gross income", and "net income", are of fundamental importance.

It might be said, with a fair show of reason, that benefit in the form of actual rental value accruing to one who occupies his own building is in the nature of income from rents. But we may not adopt such conception here. We are required to follow the standard definition of income found in the sixteenth amendment and the interpretation thereof by the Supreme Court. The well-established meaning of income in this connection is found in Eisner v. Macomber, 252 U.S. 189, 207—"'Derived-from-capital'; 'the gain derived-from-capital', etc. Here we have the essential matter: not a gain accruing to capital, not a growth or increment of value in the investment; but a gain, a profit, something of exchangeable value
74 proceeding from the property, severed from the capital however invested or employed, and coming in, being 'derived', that is, received or drawn by the recipient (the taxpayer) for his

separate use, benefit, and disposal; that is income derived from property. Nothing else answers the description."

In Bowers v. Kerbaugh-Empire Co., 271 U.S. 170, 174, the court said:

"After full consideration, this court declared that income may be defined as gain derived from capital, from labor, or from both combined, including profit gained through sale or conversion of capital. Stratton's Independence v. Howbert, 231 U.S. 399, 415; Doyle v. Mitchell Brothers Co., 247 U.S. 179, 185; Eisner v. Macomber, 252 U.S. 189, 207. And that definition has been adhered to and applied repeatedly. See e.g. Merchants L. & T. Co. v. Smietanka, supra, 518; Goodrich v. Edwards, 255 U.S. 527, 535; United States v. Phellis, 257 U.S. 156, 169; Miles v. Safe Deposit Co., 259 U.S. 247, 252–253; United States v. Supplee-Biddle Co., 265 U.S. 189, 194; Irwin v. Gevit, 268 U.S. 161, 167; Edwards v. Cuba Railroad, 268 U.S. 628, 633. In determining what constitutes income substance rather than form is to be given controlling weight. Eisner v. Macomber, supra, 206."

Whatever might be said as to the power of Congress to require life insurance companies to include in their gross income the actual or fair rental value of space occupied by them in their own buildings (a question not necessary here to determine) it is manifest to us that the amount required to be added to gross income under sec. 245 (b), before deductions may be taken, is not income when measured by the rule in Eisner v. Macomber, supra, and Bowers v. Kerbaugh-Empire Co., supra. It does not represent actual gain. It is neither of exchangeable value nor is it severed from capital. It is not something received or drawn by the taxpayer for his separate use and disposal. It is simply an arbitrary figure, determined by a mathematical formula, to which must be added rents received from other tenants and from which must be deducted taxes, depreciation and all other expenses to reach a net income of 4% per annum of the book value (not actual value) of the building at the end of any given taxable year. It does not even purport to approximate the true rental value of the space occupied. It must be increased or diminished inversely, each year, to the increase or decrease of rents received. In Burk-Waggoner Ass'n v. Hopkins, 269 U.S. 110, 114, the court said: "It is true that Congress cannot make a thing income which is not so in fact." See, also, Flint v. Stone Tracy Co., 220 U.S. 108, 145.

It is here urged, as was urged in National Life Insurance Co. v. United States, supra, that the present tax is a special excise tax laid upon life insurance companies and measured by the aggregate of certain receipts by such companies; that in levying such an excise tax Congress was not acting under the sixteenth amendment, and hence, the proper definition of income as used in that amendment, is wholly immaterial; and, since the respondent has continued to do business in corporate form, it is estopped to deny the

validity of the conditions upon which Congress has said this could be done. To so hold would be to deny the obvious fact. In form and substance the Internal Revenue Acts under consideration levy income taxes and not excise taxes. Respondent has accepted no benefits under sec. 245 (b) of either act. None are in effect granted therein. It has chosen, as it had a right to, to claim deductions allowed by sec. 245 (a) (6) and (7) of each act and to resist deficiency assessments founded upon the compulsory inclusion in gross income of that which cannot in any sense be regarded as income. The record fails to disclose that respondent has acquiesced in the provisions of these sections or recognized them as valid. See Frost v. Corporation Commission, 278 U.S. 515, 528. We therefore conclude that the inclusion of the indicated items in respondent's gross income for 1923 and 1924, respectively, as the rental value of the space occupied by it in its building, was in effect the taxation of something nontaxable (Evans v. Gore, 253 U.S. 245; Miles v. Graham, 263 U.S. 501) and was invalid.

It is said that the purpose of sec. 245 of each act was, not to include in gross income that which was not income, but to limit the deductions of taxes and other expenses paid with respect to real estate owned by life insurance companies, and of the allowance for exhaustion and obsolescence granted in sec. 245 (a) (6) and (7) of each act. It is urged that this may be done because deductions are statutory, and, although income is controlled by the Constitution, Congress may grant deductions or withhold them entirely or limit the amounts thereof.

The same argument was advanced in National Life Insurance Co. v. United States, supra, but the court there said (277 U.S., p. 520):

> "The suggestion that as Congress may or may not grant
> 76 deductions from gross income at pleasure, it can deny to one and give to another, is specious, but unsound."

Congress may of course allow to all life insurance companies the deductions granted in sec. 245 (a) (6) and (7) but having done so it cannot then say that it will deny these same deductions to those life insurance companies which own and occupy in whole or in part their own real estate unless they submit to taxation upon income which is nonexistent.

No claim is made that sec. 245 (a) (6) and (7) of the acts under consideration, by virtue of which respondent took deductions, are unconstitutional. Both the acts, 1921 and 1924, contain the usual section to the effect that if any of their provisions are held invalid, the remainder shall not be affected thereby.

The order of the Board of Tax Appeals is affirmed.

Dissenting opinion

TUTTLE, District Judge, dissenting: I cannot agree with the conclusion reached by a majority of the court nor with the views resulting in such conclusion, as expressed in the majority opinion.

It seems to me entirely clear that the statutory provisions here involved are subject to none of the constitutional objections urged by the taxpayer and upheld by the court. There are no constitutional prohibitions which prevented Congress from enacting a statute, in proper form, which would impose either an excise tax or an income tax, or both, upon life insurance companies. There is no property or income from property involved in this case which is exempted by the Constitution from taxation as was the fact in National Life Insurance Co. v. United States, 277 U.S. 508. That case, therefore, is, in my opinion, not applicable here. Congress, pursuant to the power conferred upon it by the sixteenth amendment, has seen fit by this act to impose an income tax upon certain income of life insurance companies. No effort has been made in the act to impose an excise tax. Congress, having decided, as it had the power to do, to exempt life insurance companies from an excise tax, and from any tax on income from the life insurance business proper, very properly and justly determined and enacted that, in computing the net income to be taxed, the life insurance companies should not be permitted to make deductions from gross income received from property previously accumulated (interest, dividends, and rents) unless such deductions were decreased by "the rental value", as defined in the act, of "any real estate owned and occupied" by the company. This is the real purpose and
77 result of the act, when considered and construed in its entirety. Obviously, Congress recognized that inasmuch as an effort was being made to tax only the income from property already acquired it would not be fair to permit the companies, so exempt from excise taxes and exempt from taxes on income from the life insurance business proper, to use this real estate without taking such use into account in making deductions from the gross income which were subjected to the provisions of this act. It cannot, of course, be doubted that in framing a statute to impose an income tax, Congress could impose such tax upon gross income without allowing any deductions or could allow such reasonable deductions as it deemed proper in determining the net income to be taxed.

The purpose and results of the act in question seem plain. It imposes a tax upon actual income from certain property, namely, interest, dividends, and rents, without including as income any rental value of the real estate occupied by the taxpayer company, and permits a deduction, from such gross income, which deduction takes into account the use of real estate owned and occupied by such company. This was a constitutional method of accomplishing the desired results. Section 245(b) denies deductions from gross income unless "the rental value," as defined in such section, of the afore-mentioned real estate is taken into account in computing the amount of such deductions. This is no more objectionable, from a constitutional standpoint, because it is couched in this permissive

language than it would have been if the language providing for such conditional deduction had been imperative. The majority opinion holds sec. 245(b) unconstitutional on the ground that it provides for including "the rental value," as there defined, of the space occupied by the company, in the return of gross income. I do not dissent on the ground that such "rental value," however defined or computed, is taxable as income, or constitutes income, but on the ground that it is not in reality included in gross income, nor taxed, by this act. Construing, as we must, sections 245(a) and 245(b), together and as a whole, and considering them from the standpoint of the results sought and obtained, they do not impose any tax upon "the rental value," or upon any part of the value, of the space occupied by the taxpayer, but in mathematical language provide, in substance, that if the gross deduction permitted by the act is claimed then that gross deduction must be reduced by the amount of such "rental value," as therein defined. I construe the language of sec. 245(b), which directs that if the allowed deduction is claimed 78 the so-called "rental value" shall be included "in the return of the gross income", as a mere direction as to manner of computation rather than a matter of substance. For the purpose of reducing to an algebraic formula one of the mathematical methods by which Congress might have proceeded to accomplish the object intended, let us assume that A represents the gross income, which the act defines as the "gross amount of income received from interest, dividends and rents." Let B represent "the rental value" of the "real estate owned and occupied" by the company. Let C represent the gross conditional deduction permitted by the act for taxes, expenses and depreciation. It seems plain that there is nothing in the Constitution which would have prevented Congress from enacting a tax law which provided that the net amount of income to be taxed was to be determined by taking A, the gross income, and deducting therefrom a sum to be determined by subtracting B, the rental value of the property used by the company, from C, the gross deduction conditionally permitted. The algebraic formula for this method would have been $A-(C-B)$. If we reduce this formula to its most simple algebraic form, it becomes $A+B-C$, which is the identical formula provided by the statute under consideration. Instead of providing a formula which would require a determination of the permitted deduction by subtracting B, the rental value of the property used by the company, from C, the gross deduction conditionally permitted, Congress provided the more simple formula which takes A, the gross income, and, if deduction is claimed, adds thereto B, the rental value, and then deducts C, the gross conditional deduction. This gives us the same formula, $A+B-C$. The two formulae are identical, in theory of taxation and in results. Congress had the power to impose a tax upon A, the gross income, and to provide for C, the gross deduction permitted by the act, and to reduce that gross deduction by subtracting therefrom B, the rental value of the property used. The resulting remainder to be taxed

is the same whether we add B, the rental value, to the subtrahend A or subtract it from the minuend C. Neither imposes a tax upon the use or value of real estate. Both take the "rental value" of such use, as measured by the act, into account in determining the deduction permitted. The only difference is in the manner of doing the same arithmetical problem. The act provides for adding A and B and then subtracting C, which, it seems to me, as it evidently did to Congress, is more simple than subtracting B from C and then subtracting the remainder so obtained from A.

79 The power of Congress and the constitutionality of its enactments should be determined not upon any narrow considerations but in the light of the substance of the statute, having in mind the object intended and the practical results accomplished. The meaning and purpose of this act in its entirety, including sec. 245 (b), seem to me plain and fully within the powers of Congress. In the final analysis, by sections 245 (a) and 245 (b) of the statute Congress permitted, without requiring, the deduction, from certain gross income of life insurance companies, of certain items of expense as reduced by a certain figure. That figure was referred to, in sec. 245 (b), as the "rental value" of the real estate owned and occupied by the taxpayer but its maximum was determined by a certain formula of computation prescribed by the statute. As, however, the last-mentioned figure does not, and is not intended to, represent income, but is used merely as a means of measurement of the amount of the deduction permitted, it is wholly immaterial whether it accurately represents rental value or is merely an arbitrary figure having no relation to the real rental value. Of course, even if it did actually represent rental value that would not meet the constitutional objection urged against its inclusion in, and as, income taxable under the sixteenth amendment, for the obvious reason that rental value does not constitute income. Used, however, merely for the purpose of measuring the amount of the permissible deduction in question, it does not, in my opinion, appear to be unreasonable or unfair, and I know of no reason why Congress could not, in its discretion and judgment, adopt it as part of the basis for computation of such deduction. It is, of course, obvious that these sections of the statute do not require, even indirectly, the taxpayer to pay more than the prescribed income tax upon any property except income, inasmuch as the net conditional deduction here allowed need not be claimed by the taxpayer, but may be entirely waived, in which event the latter will pay such income tax upon gross income without any deduction to which payment he can have no constitutional objection.

For the reasons stated, I reach the conclusion that the order of the Board of Tax Appeals should be set aside and the cause remanded for further proceedings not inconsistent with this opinion.

80 [Clerk's certificate to foregoing transcript omitted in printing.]

81 Supreme Court of the United States

Order allowing certiorari

Filed February 5, 1934

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(Endorsement on cover:) File no. 38,292. U.S. Circuit Court of Appeals, Sixth Circuit. Term no. 689. Guy T. Helvering, Commissioner of Internal Revenue, petitioner, vs. The Independent Life Insurance Company. Petition for a writ of certiorari and exhibit thereto. Filed December 29, 1933. File no. 689 O.T. 1933.

U. S. GOVERNMENT PRINTING OFFICE: 1934